MORTGAGE AND LAND BANK OF LATVIA

Annual Report for the year ended 31 December 2008

CONTENTS

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V a/s „Latvijas Hipotēku un zemes banka" (Bank) is a joint-stock company incorporated in the Republic of Latvia. The holder of 100% of the Bank's shares is the Ministry of Finance of the Republic of Latvia. The Bank and its subsidiaries (the Group) are engaged in banking and financial services business.

Report of the Supervisory Council and the Board of Directors

Since 2007, global economic growth has slowed down: global economic growth in 2006 was 5.1% and 5.0% in 2007. The International Monetary Fund (IMF) estimates that the growth rate for 2008 will be 3.9% (the results are not available yet), while the growth rate for 2009 is estimated to amount to 0.5%. Two key factors have contributed to the recession of economy: volatility of the financial market (US mortgage crisis, large scale financial institution bankruptcies, loss of confidence among financial market participants, stricter credit regulations) and the growth of prices for energy resources and food during the recent years.

The IMF estimates of the gross domestic product (GDP) growth in the European Union (EU) are 1.65% in 2008, 0.55% in 2009; in the forthcoming years, the growth will gradually increase, yet it will not achieve the pre-crisis levels in the next 5 years. In emerging countries (especially China and India) the growth of economy will continue, but it will be slower than before the 2008-2009 recession.

The economy of Latvia has faced radical changes after the rapid growth in the previous years (11.9% in 2006, 10.2% in 2007). Economy stabilising measures (anti-inflation measures, limitation of borrowing and internal consumption) have reduced the expansion of loans, the internal consumption and the current account deficit, but the growth of gross domestic product has dropped dramatically and entered a recession. According to the estimates of the European Commission (EC), in 2008 the negative growth of Latvia's GDP will be at -2.3% in 2008, -6.9% in 2009 and -2.4% in 2010. The Bank of Latvia estimates a 2% reduction of GDP in 2008 and a 12% reduction in 2009.

The key components of the gross domestic product growth in the previous years (real estate operations, retail, construction, financial mediation) have decreased substantially and there will be no equivalent replacements for these industries during the next 2-3 years. The competitive edge of Latvian companies is seriously undermined by inflation and the increased production costs, as well as the reduced demand and the increased competition in the existing markets.

In 2008, the export of Latvia increased by 9%, while the import decreased by 4%. The export growth can be mainly attributed to metal, chemicals and food, although the growth partially consists of re-export. The reduced import and increased export led to decrease of Latvia's external trade deficit in 2008.

With the economy slowing down faster than expected, the decrease of inflation in the end of the last year exceeded expectations and in December it stood at a mere 10.5%. The reasons for the swift reduction: steep fall in demand, drop in prices of global energy resources and the subsequently reduced burden of costs. Thus, since May in last year, when the inflation reached its peak at almost 18%, it has decreased by almost a third. Taking into account the high growth of inflation in the early months of last year and the significant reduction of consumer prices in the second half of the year, the average inflation figure for 2008 resulted in 15.4%.

The national unemployment rate in December 2008 reached 7% (4.9% in December 2007). Since the third quarter of 2008, the characteristic line for trend, which used to point downwards, has begun going upwards. The increase is relatively small so far, because the people dismissed as a result of reduction of operations by the companies have filled the vacancies that had been protractedly unfilled or in little demand, there is a demand for seasonal workers and people do not rush to register at the unemployment registry. Although, in early 2009 the unemployment will increase more rapidly and, according to estimates of expert of the Bank, it may reach 10%. The EC estimates that the unemployment in 2010 might reach even 12.7% in Latvia.

As at December 2008, banking services in Latvia were offered by 21 bank and five branches of foreign banks. There are also seven electronic money institutions and three money market funds registered in the Bank of Latvia. The State Joint Stock Company Latvijas Hipotēku un zemes banka (The Mortgage and Land Bank of Latvia) is the only commercial bank that is fully state-owned. In November 2008, by a decree of the Cabinet of Ministers intended for stabilisation of Latvian financial system, the Mortgage Bank paid 2 lats and obtained 84.83% of Parex Bank shares, which means that in fact this commercial bank is also state-controlled. Considering the short-term nature of this investment and the specifics of operations related thereto, it has no substantial impact on the operations of the Mortgage Bank and it does not increase the risks undertaken by the Bank.

During 2008, the banks' assets have increased by 6% reaching 23.2 billion lats at the end of December, the amount of granted loans increased by 11%, while the deposits (with transit funds) have decreased by 4% and the equity and reserves of banks have decreased by 1%. The non-audited profit of banks in 2008 reached 77.6 million lats, which represents only 1/5 of the 2007 earnings figure.

The growth of lending has reduced significantly since mid-2007, which is a result of the requirements of the anti-inflation plan, rise in price of credit resources and various increased credit risks. The loan market has become more transparent, thanks to the Borrowers' Registry introduced in 2008.

Report of the Supervisory Council and the Board of Directors *(continued)*

The recession of Latvian economy and the increased cost of loans have affected the quality of the commercial bank credit portfolio, which has deteriorated over the last year. At the end of 2008, the percentage of loans where payments had been overdue by more than 30 days reached 8% of the total amount of the credit portfolio (1 294 million lats).

The quality of credit portfolio in the commercial banking system has mainly deteriorated in the following segments:

1) personal loans - high-price segment and speculative transactions;
2) real estate projects;
3) retail;
4) wood processing and manufacturing of furniture;
5) hotels and entertainment objects;
6) road transport.

The prospects of recovery of problematic loans are becoming more complicated, because, as the real estate market stagnates, the price of recoverable objects is falling, the realisation terms are extending and the costs are increasing. This leads to increase of the amount of written-off debts in the financial sector.

The borrowing rate in 2009 will be moderate and the banks will mainly concentrate on the quality of the granted and existing loans. New loans will be primarily granted to financing of industries and projects for promotion of export, infrastructure projects and different innovations, which can promote the competitive edge of Latvian companies.

Taking into account the rapidly decreasing growth of economy and that the slower growth of borrowing rate has reduced the role of banks in maintenance of domestic demand, the council of the Bank of Latvia reduced the reserve requirement for bank liabilities exceeding 2 years many times in 2008 (the total decrease was from 8% to 3%) and also reduced the reserve requirement for all other liabilities included in the reserve base from 8% to 5%.

Although the US Federal Reserve reduced the dollar basic interest rate several times in 2008 (the total decrease from 4.25% to 0.25%) and the European Central Bank reduced the Euro basic interest rate from 4% to 2.5%, this period saw an increase of the average interest rate for loans issued by Latvian commercial banks (except for loans to legal entities in foreign currencies). The average interest rate for private borrowers (in lats) increased from 17.3% (December 2007) to 17.5% (December 2008), while for legal entities the increase for the corresponding period was from 9.7% to 13.4%. The average interest rate for private borrowers (in foreign currencies) grew from 6.8% (December 2007) to 7.5% (December 2008), while for legal entities during the corresponding period there was a reduction from 7.2% to 6.7%.

The growth rate of the Mortgage Bank in 2008 has decreased, as the case is in the entire banking system. The gross amount of assets of the Mortgage Bank increased by 38.3 million lats or 4.1% and amounted to 962.2 million lats. By the amount of assets at the end of December, the Bank was ranked 8th among the commercial banks in Latvia (4.1% market share). The profit of the Bank for 2008 reached 1.2 million lats, which was 4.9 million lats or 79% less than for the corresponding period of the previous year. The main reason behind the reduction is formation of reserves for insecure assets.

The credit portfolio of the Mortgage Bank increased by 69 million lats or 10.4% in 2008 and amounted to 731.6 million lats. The bank was ranked 6th among Latvian commercial bank according to the size of its credit portfolio (4.4% market share). The Mortgage Bank was the seventh largest bank in Latvia by the amount of loans issued to businesses (5.2% market share) and the seventh largest bank by the amount of loans issued to private borrowers (3.3% market share).

The amount of deposits in the Bank during 2008 increased by 19 million lats or 7% and amounted to 298 million lats. The Mortgage Bank was ranked 10th among Latvian commercial banks by the amount of deposits (including transit funds) at the end of December (3.1% market share).

The amount of debt securities issued by the Mortgage Bank decreased by 11.4 million lats or 21% in 2008 and amounted to 42 million lats. In May, the Bank issued mortgage bonds worth EUR 12.7 million; in June, bonds worth LVL 10 million and EUR 9 million were redeemed, which were the first short-term bonds in the Baltic States listed on the stock exchange and not issued by the State Treasury.

To provide the customers with an opportunity to conveniently place their funds and make savings in pension funds, in the first half of 2008, the Mortgage Bank completed the acquisition process of IPS Suprema Fondi and formed a Joint Stock Company Ieguldījumu pārvaldes sabiedrība HIPO FONDI (Investment Management Company HIPO FONDI), and also commenced the attraction of customers to three second-level pension plans in all branches of the Bank.

Report of the Supervisory Council and the Board of Directors *(continued)*

During the second half of 2008 and in early 2009, the international credit rating agencies have gradually decreased their ratings for Latvia to the lowest investment grade, pointing out that the downgrading of credit ratings reflects the recession of the economic situation, which has been sharper that predicted. The Mortgage Bank is a fully state-owned bank and its rating cannot exceed that of the country. Thus, the *Moody's Investor service* international agency downgraded the rating of the Mortgage Bank along with that of Latvia. The ratings for the bank are as follows:

- long-term foreign currency investments – ***Baa1*** (future outlook - negative),
- short-term foreign currency investments – ***P2***,
- financial stability rating – ***D-*** (future outlook - negative),
- mortgage bond rating – ***A2,***

which are investment grade ratings.

In 2008, the Mortgage Bank continued to implement various development programmes, which, by assignment of the government, include providing support to certain groups of businesses and individuals - crediting programmes for small and medium enterprises, housing guarantee programme, rural development programme. The Bank, as a national bank, pays particular attention to implementation of programs that can help Latvian businessmen continue or commence their business even in such adverse economic conditions.

2008 saw the completion of the programme co-financed by the European Social Fund - Training, Consulting and Financial Support for Commencement of Business and Self-Employment. The project included training of 998 future businessmen, 600 applicants for the support submitted their business plans and 327 of them were granted financial support in the form of grants and loans.

2008 also saw the completion of the programme co-financed by the European Regional Development Fund - Crediting of Beginners in Business. 291 loans totalling 22.76 million lats were granted under this project.

To promote business activity in Latvia, the Cabinet of Ministers issued a decree on the 22nd of May 2008 (decree No. 275) to commence a new programme - Support Programme for Improvement of Competitiveness of Businesses, which is implemented by the Mortgage Bank. Until the end of the year, there were 32 loans granted for the total amount of 14.17 million Euros under this programme.

In August, the Mortgage Bank commenced cooperation with the association *Support Fund for Latvian Businesswomen in Rural Areas* concerning the support of business organised by women in rural areas in Latvia, which provides micro-loans for development of business. 50 000 lats provided for the project have been issued.

During 2008, the Mortgage Bank and environment protection activist groups have jointly implemented several projects the invite the society to act in an environmentally friendly way and to think in long term. Some of the examples include: the Green Guidebook devoted to green way of living published and promoted together with the organisation Zaļā Brīvība (Green Freedom) and the project of preservation of sand-dunes carried out jointly with the Green Movement of Latvia. In this way the Mortgage Bank presents itself as a socially responsible entity.

The Mortgage Bank continued cooperation with the Platforma Records record company and issued CDs with fairy-tales for children and their parents. Four records were issued in total: Grimm's Fairy Tales, Emil and the Berlin Boys, Peter Pan, and the Cat's Mill. This project demonstrates that the family is one of the most important values for the Bank.

In the second quarter of 2008, the Mortgage Bank and Aizkraukles Bank concluded an agreement on financing of small and medium enterprises, whereby the Mortgage Bank provides the Aizkraukles Bank with a syndicated loan worth 10 million Euros required for the implementation of the programme.

Early in the year, the Bank signed cooperation agreements with leaders of all regional funds in Latvia, as well as with the Limbaži Region Council on organisation of project tenders. The Mortgage Bank supported the best works of project tenders staged by the funds, which promote the self-initiative of local residents for improvement of their living environment.

Early 2008 saw the commencement of a large-scale education programme for residents and building managers on the renovation of residential buildings - from regional seminars, informative articles in the press, expert opinions, informative video clips and handouts, to participation in projects organised by other institutions. In 2008, 100 loans for renovation of residential buildings were granted, which amounted to 2.5 million lats in total.

***Report of the Supervisory Council and the Board of Directors** (continued)*

The quality of Bank’s services has been appreciated by customers. In March, the branches of the Mortgage Bank participated in the event called Praise Good Service organised by *Labsserviss.lv*, which included participation from 50 Latvian companies with 800 service points, and the Rēzekne branch of the Mortgage Bank was placed among top 10 in this competition.

One of the priorities of the Mortgage Bank in 2008 has been the financing of innovation projects. Active work was directed towards the achievement of this goal, and, as a result, 10% of all loans granted in 2008 have been destined for implementation of innovations in businesses.

In 2008, the Mortgage Bank continued to update and improve the network of branches and sub-branches. The Balvi branch started work in brand-new premises in January, followed by a sub-branch of the Riga office in June, which is located in Riga, in the premises of Land Register Department. The Ūnijas branch also has moved to new, larger premises in October. In order to optimise the Bank operations, the Salacgrīva sub-branch was closed in March 2008. At the end of 2008, the Bank had 29 branch in Riga and in each regional centre of Latvia, as well as 8 sub-branches in different regions of Latvia.

17 new ATMs were installed during 2008: in the newly opened Balvi branch, Ādaži, Ezere, Jūrkalne, Piltene, Dobele, Cesvaine, Barkava, Riga (in the premises of the sub-branch of the Riga office), Lēdmane, Rēzekne, Krāslava, Pļaviņas, Rugāji, Nītaure, Skaistkalne and Lejasciems. Thus, the network of ATMs of the Mortgage Bank consisted of 58 ATMs at the end of 2008. In September 2008, the Mortgage Bank concluded an agreement with SEB Banka on a *friendly* ATM network - as from the 1st October, the customers of the Mortgage Bank can withdraw cash free of charge from 58 ATMs of the Mortgage Bank, 14 ATMs of Rietumu Banka, 202 ATMs of Latvijas Krājbanka and, in addition, 218 ATMs of the SEB Banka throughout Latvia. At the end of 2008, the network of ATMs of the Mortgage Bank and the *friendly* ATM network accounted for almost a half of the total network of ATMs in Latvia.

In the fourth quarter of 2008, the Information Technology Department of the Bank successfully completed the transition of the ATM network from the network of First Data Latvia (FDL) to the Bank's management network, thus improving the functionality and the options of monitoring of the ATMs.

Baiba Bāne	Inesis Feiferis
Chairman of the Council	Chairman of the Board

The Supervisory Council and the Board of Directors of the Bank

Supervisory Council (at 31 December 2008)

Baiba Bāne	Chairman of the Council
Dāvids Tauriņš	Deputy Chairman of the Council (appointed on 1 November 2008)
Jānis Šnore	Member of the Council
Matīss Markuss	Member of the Council (appointed on 1 November 2008)
Iveta Strautiņa	Member of the Council

During the reporting year Gundega Šulca, Andris Liepiņš, Vija Gēme, Baiba Paševica un Dace Ratniece resigend from the Council and Dāvids Tauriņš and Matīss Markuss were appointed as Deputy Chairman of the Council and member of the Council..

Board of Directors (at 31 December 2008)

Inesis Feiferis	Chairman of the Board
Rolands Paņko	Deputy Chairman of the Board
Aija Laicāne	Member of the Board
Jēkabs Krieviņš	Member of the Board
Andris Riekstiņš	Member of the Board

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On 21 January 2009 Aija Laicāne resigned from the Board.

On 11 February 2009 the Council appointed Jānis Bērziņš as Member of the Board.

Statement of Responsibility of the Supervisory Council and the Board of Directors

Riga 11 March 2009

The Supervisory Council and the Board of Directors (Management) is responsible for preparing financial statements from the books of prime entry of the Group and the Bank for each financial period that present fairly the state of affairs of the Group and the Bank as at the end of the financial period and the results of their operations and cash flows for that period according to the International Financial Reporting Standards as adopted by the European Union..

Management confirms that suitable accounting policies have been used and applied consistently and reasonable and prudent judgments and estimates have been made in the preparation of the financial statements on pages 9 to 66 for the year 2008. Management also confirms that applicable International Financial Reporting Standards as adopted in EU have been used in preparation of the financial statements and that these financial statements have been prepared on a going concern basis. Appropriate accounting policies have been applied on a consistent basis.

Management is responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the Group and the Bank and to prevent and detect fraud and other irregularities. Management is also responsible for managing the Bank in compliance with the Law on Credit Institutions, regulations of the Bank of Latvia and the Financial and Capital Market Commission as well as other legislation of the Republic of Latvia.

On behalf of the management,

Baiba Bāne	Inesis Feiferis
Chairman of the Council	Chairman of the Board

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSC Mortgage and Land Bank of Latvia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of JSC Mortgage and Land Bank of Latvia and its subsidiaries (the Group) and the financial statements of JSC Mortgage and Land Bank of Latvia (the Bank) on pages 9 to 66 which comprise the balance sheets as of 31 December 2008 and the income statements, statements of changes in equity and cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Group and the Bank as of 31 December 2008, and of their financial performance and their cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

We have read the Management Report set out on pages 2 to 5 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the financial statements for 2008.

PricewaterhouseCoopers SIA
Certified audit company
Licence No. 5

Juris Lapshe
Member of the Board

Ilandra Lejiņa
Certified auditor in charge
Certificate No. 168

Riga, Latvia
11 March 2009

INCOME STATEMENT
(all amounts in thousands of Euro)

	Notes	2008		2007	
		Group	**Bank**	**Group**	**Bank**
Interest income	5	94,061	90,418	74,626	71,107
Interest expense	6	(63,937)	(62,698)	(42,883)	(42,631)
Net interest income		**30,124**	**27,720**	**31,743**	**28,476**
Fee and commission income	7	5,821	5,700	5,851	5,838
Fee and commission expense	8	(1,419)	(1,383)	(1,315)	(1,224)
Net fee and commission income		**4,402**	**4,317**	**4,536**	**4,614**
Dividend income		18	1,157	-	711
Net trading income	9	3,068	3,108	3,048	3,004
Other operating income	10	6,783	4,895	5,986	4,452
Staff costs	11	(14,368)	(12,799)	(14,280)	(12,942)
Administrative and other operating expenses	12	(13,021)	(11,545)	(11,981)	(10,903)
Depreciation and amortisation		(3,325)	(2,877)	(3,510)	(3,270)
Provision for impairment losses	13	(13,204)	(12,159)	(4,589)	(4,055)
Profit before income tax		**477**	**1,817**	**10,953**	**10,087**
Income tax expense	14	(219)	(100)	(1,683)	(1,342)
Net profit for the period		**258**	**1,717**	**9,270**	**8,745**
Attributable to:					
Equity holders of the Bank		255	-	-	-
Minority interest		3	-	-	-

The notes on pages 14 to 66 are an integral part of these financial statements.

These financial statements on pages 9 to 66 have been accepted by the Board of Directors on 3 March 2009 and accepted by the Supervisory Council on 11 March 2009 and are signed by:

Baiba Bāne
Chairman of the Council

Inesis Feiferis
Chairman of the Board

BALANCE SHEET
(all amounts in thousands of Euro)

	Notes	31/12/08		31/12/07	
Assets		**Group**	**Bank**	**Group**	**Bank**
Cash and balances with Central Bank	15	64,193	64,193	94,287	94,287
Trading securities	16	5,491	5,280	4,651	4,651
Investment securities – held to maturity	16	91,163	91,020	18,583	18,583
Investment securities – available for sale	16	37,416	37,416	77,021	77,021
Due from credit institutions	18	93,322	92,962	149,218	148,921
Derivative financial instruments	19	2,250	2,250	120	120
Loans to customers	20	1,056,320	1,033,823	950,276	939,593
Investment properties	17	2,598	2,598	3,011	3,011
Investments in subsidiaries and associated undertakings	21	421	1,278	785	1,312
Intangible assets	22	3,463	2,763	2,871	2,742
Property and equipment	23	12,389	10,868	12,770	11,307
Current income tax assets		1,632	1,429	455	404
Other assets	24	7,114	2,071	4,640	1,026
Deferred expenses and accrued income		1,022	802	1,154	980
Total assets		**1,378,794**	**1,348,753**	**1,319,842**	**1,303,958**
Liabilities					
Due to credit institutions	25	733,103	705,641	707,597	695,412
Due to customers	26	429,847	430,005	401,426	402,032
Derivative financial instruments	19	777	777	185	185
Transit funds		3,238	3,238	3,664	3,664
Issued debt securities	27	57,854	57,854	74,692	74,692
Other liabilities	28	18,616	17,613	17,023	15,952
Deferred income and accrued expenses		3,714	2,678	3,968	2,962
Current income tax liabilities		-	-	70	-
Deferred tax liabilities	29	1,431	1,431	1,370	1,332
Subordinated liabilities	30	44,236	44,236	18,927	18,927
Total liabilities		**1,292,816**	**1,263,473**	**1,228,922**	**1,215,158**
Shareholder's equity					
Share capital	31	69,028	69,028	69,028	69,028
Reserve capital	31	3,591	2,935	3,591	2,935
Minority interest		41	-	-	-
Revaluation deficit on available for sale investments		(5,068)	(5,068)	(2,191)	(2,191)
Retained earnings		18,386	18,385	20,492	19,028
Total shareholder's equity		**85,978**	**85,280**	**90,920**	**88,800**
Total liabilities and shareholder's equity		**1,378,794**	**1,348,753**	**1,319,842**	**1,303,958**
Off balance sheet items					
Contingent liabilities	34	34,159	34,159	16,300	16,300
Financial commitments	34	42,325	56,060	60,465	94,087

The notes on pages 14 to 66 are an integral part of these financial statements.

These financial statements on pages 9 to 66 have been accepted by the Board of Directors on 3 March 2009 and accepted by the Supervisory Council on 11 March 2009 and are signed by:

Baiba Bāne	Inesis Feiferis
Chairman of the Council	Chairman of the Board

CONSOLIDATED STATEMENT OF CHANGES IN THE GROUP'S EQUITY
(all amounts in thousands of Euro)

	Attributable to equity holders					
	Share Capital	**Reserve capital**	**Revaluation deficit on available for sale investments**	**Retained earnings**	**Minority interest**	**Total equity**
Balance as at 31 December 2006	**69,028**	**3,591**	**(875)**	**13,214**	**-**	**84,958**
Available-for-sale investments: - Fair value gains less losses	-	-	(1,316)	-	-	**(1,316)**
Net income recognised directly in equity	-	-	(1,316)	-	-	**(1,316)**
Profit for the year	-	-	-	9,270	-	**9,270**
Total recognised income for 2007	**-**	**-**	**(1,316)**	**9,270**	**-**	**7,954**
Distribution of profit – payment for use of state capital	-	-	-	(1,992)	-	**(1,992)**
Balance as at 31 December 2007	**69,028**	**3,591**	**(2,191)**	**20,492**	**-**	**90,920**
Available-for-sale investments: - Fair value gains less losses	-	-	(2,877)	-	-	**(2,877)**
Net income recognised directly in equity	-	-	(2,877)	-	-	**(2,877)**
Profit for the year	-	-	-	255	3	**258**
Total recognised loss for 2008	**-**	**-**	**(2,877)**	**255**	**3**	**(2,619)**
Minority share of IPAS „Hipo fondi" on the date of acquisition*	-	-	-	-	38	**38**
Distribution of profit – payment for use of state capital	-	-	-	(2,361)	-	**(2,361)**
Balance as at 31 December 2008	**69,028**	**3,591**	**(5,068)**	**18,386**	**41**	**85,978**

* IPAS "Hipo fondi" was acquired in February 2008 and the Group owns 83% of IPAS "Hipo fondi" shares.

The notes on pages 14 to 66 are an integral part of these financial statements.

STATEMENT OF CHANGES IN THE BANK'S EQUITY
(all amounts in thousands of Euro)

	Share Capital	Reserve capital	Revaluation deficit on available for sale investments	Retained earnings	Total equity
Balance as at 31 December 2006	**69,028**	**2,935**	**(875)**	**12,275**	**83,363**
Available-for-sale investments:					
- Fair value gains less losses	-	-	(1,316)	-	**(1,316)**
Net income recognised directly in equity	-	-	(1,316)	-	**(1,316)**
Profit for the year	-	-	-	8,745	**8,745**
Total recognised income for 2007	**-**	**-**	**(1,316)**	**8,745**	**7,429**
Distribution of profit – payment for use of state capital	-	-	-	(1,992)	**(1,992)**
Balance as at 31 December 2007	**69,028**	**2,935**	**(2,191)**	**19,028**	**88,800**
Available-for-sale investments:					
- Fair value gains less losses	-	-	(2,877)	-	**(2,877)**
Net income recognised directly in equity	-	-	(2,877)	-	**(2,877)**
Profit for the year	-	-	-	1,717	**1,717**
Total recognised loss for 2008	**-**	**-**	**(2,877)**	**1,717**	**(815)**
Distribution of profit – payment for use of state capital	-	-	-	(2,361)	**(2,361)**
Balance as at 31 December 2008	**69,028**	**2,935**	**(5,068)**	**18,384**	**85,279**

The notes on pages 14 to 66 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Cash flows from operating activities				
Profit before taxation	477	1,817	10,953	10,087
Depreciation and amortisation	3,325	2,877	3,510	3,270
Increase in provision for impairment losses	10,309	9,506	2,063	1,559
Loss from foreign exchange revaluation	-	-	3	47
Profit from sale of property and equipment	(139)	(1)	(7)	(11)
Increase in deferred income and accrued expenses	997	745	1,841	1,480
(Increase) / decrease in deferred expenses and accrued income	132	178	(293)	(252)
Increase in other assets	(8,401)	(6,669)	(2,511)	(1,872)
Increase in other liabilities	2,186	2,254	9,836	9,557
Increase in cash and cash equivalents from operating activities before changes in assets and liabilities	**8,886**	**10,707**	**25,395**	**23,865**
Increase in balances due from credit institutions	(13,261)	(13,261)	(21,413)	(21,413)
Increase in loans to customers	(113,520)	(101,089)	(241,577)	(244,952)
Decrease in trading securities	(840)	(629)	(566)	(566)
Increase in balances due to credit institutions	18,782	3,783	268,919	272,090
Increase in balances due to customers	28,420	27,972	11,498	11,902
Decrease in transit funds	(425)	(425)	(418)	(418)
Increase / (decrease) in debt securities issued	(16,838)	(16,838)	13,209	13,209
Cash and cash equivalents generated from / (used in) operating activities	**(88,796)**	**(89,780)**	**55,047**	**53,717**
Corporate income tax paid	**(1,476)**	**(1,026)**	**(3,056)**	**(2,489)**
Cash flows from investing activities				
Increase in investment securities	(35,616)	(35,474)	(24,213)	(24,213)
Purchases of property and equipment	(3,914)	(2,517)	(5,787)	(4,402)
Proceeds from property and equipment disposal	518	60	85	23
Proceeds from disposal of investments in associated entities	386	34	28	3
Acquisition of investments in associated entities	(21)	-	(213)	(712)
Cash and cash equivalents used in investing activities	**(38,647)**	**(37,897)**	**(30,100)**	**(29,301)**
Cash flows from financing activities				
Proceeds from subordinated liabilities	30,000	30,000	-	-
Subordinated liabilities repaid	(4,695)	(4,695)	-	-
Dividend paid	(2,360)	(2,360)	(1,992)	(1,992)
Cash and cash equivalents generated from / (used in) financing activities	**22,944**	**22,944**	**(1,992)**	**(1,992)**
Increase / (decrease) in cash and cash equivalents	(105,975)	(105,759)	19,899	19,935
Cash and cash equivalents at the beginning of the year	187,728	187,615	167,832	167,728
Effect of exchange rates on cash and cash equivalents	-	-	(3)	(47)
Cash and cash equivalents at the end of the year (see Note 32)	**81,753**	**81,856**	**187,728**	**187,616**

The notes on pages 14 to 66 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1 GENERAL INFORMATION

The Mortgage and Land Bank of Latvia was established as a state-owned commercial bank on 19 March 1993 by the Government of Latvia based on the Decree No 140 adopted by the Cabinet of Ministers. The Bank was registered with the Register of Enterprises of the Republic of Latvia on 3 June 1993. According to the Commercial Law the Bank was registered in the Commercial Register on 14 July 2004.

The operations of the Bank are regulated by the law On Credit Institutions and other effective laws of the Republic of Latvia, the Statutes of the Bank, the instructions of the Bank of Latvia and Financial and Capital Market Commission, as well as the decrees and regulations of the Cabinet of Ministers of the Republic of Latvia. The Bank is under the jurisdiction of the Ministry of Finance of the Republic of Latvia that represents the interests of the shareholder on behalf of the Cabinet of Ministers and holds 100% of the Bank's shares.

These financial statements on pages 9 to 66 have been accepted by the Board of Directors on 3 March 2009 and accepted by the Supervisory Council on 11 March 2009.

2 ACCOUNTING POLICIES

(1) Basis of preparation

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union, on a going concern basis. In preparation of the financial statements on a going concern basis the management considered the Bank's and the Group's financial position, access to financial resources and analysed the impact of the recent financial crisis on future operations of the Bank and the Group The financial statements are prepared under the historical cost convention as modified by the fair valuation of financial assets held as available-for-sale, trading securities, derivative financial instruments and investment properties.

The preparation of financial statements in accordance with EU International Financial Reporting Standards requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the Management's best knowledge of current events and actions, actual results ultimately may differ from those estimates, see also Note 2(26).

Recent volatility in global and Latvian financial markets. The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia, Latvia and elsewhere. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

Management is unable to reliably estimate the effects on the Group's and the Bank's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's and the Bank's business in the current circumstances.

Impact on liquidity:

The volume of wholesale financing has significantly reduced recently. Such circumstances may affect the ability of the Group and the Bank to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

Disappearance of an active market for quoted financial instruments:

As a result of the recent volatility in financial markets there are no longer regularly occurring transactions on an arm's length basis for fixed income securities quoted on market, therefore the management is regularly carrying out assessment of the markets where fixed income securities held by the Bank are traded to determine whether securities are still quoted on active markets in accordance with IAS 39.AG71.

NOTES TO THE FINANCIAL STATEMENTS

2 ACCOUNTING POLICIES (continued)

(1) Basis of preparation (continued)

In the reporting period the Bank reclassified certain securities from trading and available for sale categories to held to maturity category. Reclassification of trading securities was done in accordance with the IASB issued amendments to IAS 39 *Financial Instruments* where an entity is permitted to transfer securities out of the trading category in rare circumstances arising from a single event that is unusual and highly unlikely to reoccur in the near term if the asset is no longer held for the purpose of selling it in the near term and the entity has the intention and ability to hold the asset long term. Reclassification of available for sale securities was done in accordance with IAS 39 *Financial Instruments,* paragraph 54 where in the result of a change in intention it becomes appropriate to carry a financial asset at cost or amortised cost. Reclassifications took place as of 1 July 2008. The fair value carrying amount of trading and available for sale securities on 1 July 2008 became their new cost or amortised cost. See Note 16.

Impact on borrowers:
Borrowers of the Group and the Bank may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for borrowers may also have an impact on the Management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, the Management has properly reflected revised estimates of expected future cash flows in its impairment assessments.

Impact on collateral:
The amount of provision for impaired loans is based on the Management's appraisals of these assets at the balance sheet date after taking into consideration the cash flows that may result from foreclosure less costs for obtaining and selling the collateral. The market in Latvia for many types of collateral, especially real estate, has been severely affected by the local economic slowdown resulting in there being a low level of liquidity for certain types of assets. As a result, the actual realisable value on foreclosure may differ from the value ascribed in estimating allowances for impairment.

The accompanying financial statements are reported in thousands of lats, unless otherwise stated. Functional currency of the Bank and Group is Latvian lats.

The accounting policies used in the preparation of the financial statements for the period ended 31 December 2008 are consistent with those used in the annual financial statements for the year ended 31 December 2007, except as referred to above in the "Disappearance of an active market for quoted financial instruments" section.

(2) Consolidation and investments in subsidiaries

Consolidation
Subsidiary undertakings, in which the Bank, directly or indirectly, has power to exercise control over financial and operating policies, and where operating volumes are substantial, have been consolidated, by adding together similar types of assets, liabilities, income and expenses.

For the purposes of consolidation, all intercompany transactions, balances and unrealised surpluses and deficits on transactions between the Group companies have been eliminated. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Subsidiaries
Investments in subsidiaries are accounted for under the cost method in the separate financial statements of the Bank. The Bank recognises income from the investment only to the extent that the Bank receives dividends from the accumulated profits of the subsidiaries arising after the date of acquisition.

Associates
Associates are all entities over which the Group and the Bank has significant influence but not control. Investments in associates are accounted for under cost method in Bank's financial statements and using the equity method in

NOTES TO THE FINANCIAL STATEMENTS

Group's financial statements.

2 ACCOUNTING POLICIES (continued)

(3) Foreign currency translation

Transactions denominated in foreign currencies are recorded in lats at actual rates of exchange set forth by the Bank of Latvia at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the rate of exchange prevailing at the end of period. Any gain or loss resulting from a change in rates of exchange subsequent to the date of the transaction is included in the income statement.

The applicable rates for the principal currencies held by the Group and the Bank were as follows:

31 December 2008			31 December 2007		
1 EUR	=	LVL 0.702804	1 EUR	=	LVL 0.702804
1 USD	=	LVL 0.495000	1 USD	=	LVL 0.484000
1 GBP	=	LVL 0.728000	1 GBP	=	LVL 0.963000

(4) Income and expense recognition

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Fees related to loans issuing are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

(5) Trading and investment securities

Trading and investment securities are comprised of the following categories:

- Trading securities comprise fixed income securities and equity shares held by the Bank for trading purposes. They are accounted for at fair value and all gains and losses arising from changes in the fair value are included in the income statement as part of net trading income.
- Investment securities available-for-sale comprise treasury bills and other fixed income securities held by the Bank for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. They are stated at fair value with all gains and losses from revaluation recognised in equity, through the statement of changes in equity, except for impairment losses, until derecognition, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement as part of provision for impairment loss.
- Investment securities held-to-maturity comprise debt securities with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. They are carried at amortised cost, that is calculated based on the purchase price of the securities

NOTES TO THE FINANCIAL STATEMENTS

adjusted by discount or premium amortised over the tem of the securities, using the effective interest rate method.

2 ACCOUNTING POLICIES (continued)

(5) Trading and investment securities (continued)

The Group assesses at each balance sheet date whether there is objective evidence that available-for-sale and held to maturity investment securities are impaired, either individually or as a class if individually not significant. If any such evidence exists, for available for sale investments the cumulative impairment loss - measured as the difference between the acquisition cost of the asset and the current fair value, less any impairment loss previously recognised - is removed from equity and recognised in the income statement. For held to maturity investments the cumulative impairment loss - measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate – is reduced through use of an allowance account and the amount of the loss is recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not subsequently reversed.

Impairment losses recognised in the income statement on debt instruments are subsequently reversed if a fair value increase is observed that can be objectively related to an event occurring after the impairment loss was recognised. The assessment of the evidence for impairment and the determination of the amount of impairment or its reversal requires the application of management's judgement and estimates.

(6) Due from banks

Amounts due from other banks are recorded when the Group and the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortised cost.

(7) Loans and receivables

Loans and advances to customers are accounted for as loans and receivables and are carried at amortised cost. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All loans are recognised when cash is advanced to borrowers.

For the purposes of these financial statements, finance lease receivables are included in loans and advances to customers.

Management considers risks for all loans to determine the provision for loan impairment and possible losses.

Provisions for individual loan impairment are established if there is objective evidence that it will not be possible to collect all amounts due according to the original contractual terms of loans. The amount of the provision is the difference between the carrying amount and the recoverable amount, being determined as the present value of expected cash flows, including amounts recoverable from guarantees and collateral. Impairment losses are always recognised through an allowance account.

In addition to provisions for individual loans, provisions for homogeneous groups of loans based on similarities of credit risk involved, loan size, quality and loan terms are also established. The provision for loan impairment losses for those loans included within homogeneous groups have been estimated based upon historical patterns of losses in each group, the historic pattern of timeliness of payments and reflecting the current economic climate in which the borrowers operate.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss and disclosed as part of provision for impairment loss.

NOTES TO THE FINANCIAL STATEMENTS

The methodology and assumptions used are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2 ACCOUNTING POLICIES (continued)

(8) Intangible Assets including Goodwill

Acquired computer software and licences are recognised as intangible assets on the basis of the costs incurred to acquire and bring to use the software. These costs are amortised on the basis of their expected useful lives (5 years).Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisition is reported in the balance sheet as an intangible asset and is measured at cost less any accumulated impairment loss. The goodwill is assessed during each reporting period to determine whether the goodwill is impaired; such impairment loss is determined on the basis of the estimated recoverable amount of the goodwill. The assessment of the impairment of goodwill requires the application of management's judgement, including estimates of future cash flows of the appropriate cash generating unit based on management's business plans, discounted at an appropriate discount rate. Identifiable intangible assets arising on acquisition whose fair value can be measured reliably are recognised separately from goodwill and amortised on a straight-line basis over their expected useful lives. The identification and fair valuation of such intangible assets may require the application of management's judgement and, where applicable, estimates of the attributable cost of the asset or future cash flows from the Group's ownership of the asset discounted at an appropriate discount rate.

(9) Property and equipment

All property and equipment is stated at historical cost less accumulated depreciation. Depreciation is provided using the straight-line method to write off the cost of each asset to its residual value over the estimated useful life of the asset. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.
The annual rates of fixed asset depreciation are:

Category	Depreciation rate
Buildings	2 % p.a.
Furniture and fittings	10 - 20 % p.a.
Computers and equipment	10 - 33 % p.a.
Motor vehicles	17 % p.a.
Leasehold improvements	over the term of the lease agreements

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.Gains and losses on disposals of property and equipment are recognised in the income statement in the period of disposal. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to income statement during the financial period in which they are incurred.. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Property and equipment are periodically reviewed for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

(10) Investment Properties

Investment property comprises land or buildings, which are held in order to earn rentals or for capital appreciation or both, and which are not occupied by the companies in the Group or otherwise held for sale. Property held under operating lease is classified as investment property if, and only if, it meets the definition of an investment property.

Investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary, for any

NOTES TO THE FINANCIAL STATEMENTS

difference in the nature, location or condition of the asset. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections. Changes in the fair value of investment property are recorded in the income statement as part of other operating income.

2 ACCOUNTING POLICIES (continued)

(11) Leases - when the Group is a lessor

Finance lease receivables at commencement of the lease are recognised at the lower of the fair value of the leased asset or the present value of minimum lease payments. The net investment in finance leases is recorded in the balance sheet net of taxes and the related provision for impairment.

Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

Assets under operating leases are recognised as fixed assets at historical cost net of accumulated depreciation. Depreciation is calculated on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life of fixed assets that is determined based on useful lives of similar assets of the Group.

(12) Financial liabilities carried at amortised cost

Financial liabilities carried at amortised cost are mainly amounts due to customers and due to banks. These are recognised initially at cost, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Financial liabilities are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

(13) Derivative financial instruments

Derivative financial instruments including foreign currency swaps are initially recognised at fair value and subsequently measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and liabilities when the fair value is negative. Changes in the fair value of derivatives are reported in the income statement. The Group and the Bank do not use hedge accounting.

(14) Corporate income tax

Corporate income tax for the reporting period is included in the financial statements based on the management's calculations prepared in accordance with tax legislation of the Republic of Latvia.

Deferred tax is provided in full, using liability method, on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The deferred tax is calculated based on currently enacted tax rates that are expected to apply when the temporary differences reverse. The principal temporary differences arise from different fixed asset depreciation rates, revaluation of investment properties, as well as tax losses carried forward. Deferred tax assets and liabilities are netted only within the individual companies of the Group.

Where an overall deferred taxation asset arises, it is only recognised in the financial statements where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(15) Cash and cash equivalents

Cash and cash equivalents comprise cash and demand deposits with the Bank of Latvia and other credit institutions, deposits with and from other credit institutions with remaining maturity of 3 months or less.

(16) Mortgage bonds coverage register

NOTES TO THE FINANCIAL STATEMENTS

The coverage register of mortgage bonds at the Bank is maintained in accordance with the legislation of the Republic of Latvia, including regulatory documents covering mortgage transactions.

2 ACCOUNTING POLICIES (continued)

(16) Mortgage bonds coverage register (continued)

The Bank manages mortgage claims included in the coverage register of mortgage bonds according to their remaining value, as well as substitute coverage separately from other assets.

The mortgage claims included in the coverage register of mortgage bonds according to their remaining value are used to ensure that those liabilities that result from the issue of mortgage bonds are met.

Mortgage bonds in circulation according to their total face value are fully covered with mortgage loans. The interest expense on mortgage bonds is covered with the interest income from mortgage loans of the same amount.

(17) Provisions

Provisions are recognised when the Group or the Bank has a present legal or constructive obligation as a result of past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. These provisions relate to the guarantees issued and other off balance sheet items.

(18) Employee benefits

The Group and the Bank pays social security contributions for state pension insurance and to the state funded pension scheme in accordance with Latvian legislation. State funded pension scheme is a defined contribution plan under which the Group and the Bank pay fixed contributions determined by the law and they will have no legal or constructive obligations to pay further contributions if the state pension insurance system or state funded pension scheme are not able to settle their liabilities to employees. The social security contributions are recognised as an expense on an accrual basis and are included within staff costs.

(19) Fair values of financial assets and liabilities

Fair value is the amount for which assets could be exchanged, or liability settled, between knowledgeable, willing parties in an arms length transaction. Fair values of financial assets or liabilities, including derivative financial instruments, in active markets are based on quoted market prices.

If the market for a financial asset or liability is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of discounted cash flow analysis, option pricing models and recent comparative transactions as appropriate.

Where, in the opinion of the Management, the fair values of financial assets and liabilities differ materially from their book values, such fair values are separately disclosed in the notes to the accounts.

(20) Off-setting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the assets and settle the liability simultaneously.

(21) Recognition and derecognition of financial assets

NOTES TO THE FINANCIAL STATEMENTS

Purchases and sales of trading securities and investment securities that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales), are recognised at settlement date, which is the date, when the asset is delivered or given to the Group or the Bank. Any change in the fair value of the asset during the period between the purchase date and the settlement date is recognised in the income statement or in equity reserve. Otherwise such transactions are treated as derivative instruments until settlement.

2 ACCOUNTING POLICIES (continued)

(21) Recognition and derecognition of financial assets (continued)

The Group and the Bank derecognise financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group and the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale

(22) Initial recognition of financial instruments

Trading securities, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument.

(23) Property held for sale

Property is classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Property held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

(24) Financial guarantees

The Group measures issued financial guarantees initially at their fair value, which is normally evidenced by the amount of fees received. This amount is then amortised on a straight-line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at balance sheet date.

(25) Off-balance sheet instruments

In the ordinary course of business, the Group and the Bank utilise off-balance sheet financial instruments including commitments to extend loans and advances, financial guarantees and commercial letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The methodology for provisioning against off-balance sheet instruments is given in Note 2(17) above.

(26) Critical Accounting Estimates and Judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Such estimates and assumptions are outlined below:

NOTES TO THE FINANCIAL STATEMENTS

- Impairment losses of loans and advances. The Group reviews its loan portfolio to assess impairment on a regular basis as described in Note 2(7). The Group uses stress tests to determine possible impact of changes in one or more variables used in estimation of the provision for impairment losses on the financial result. To the extent that past due loans in the existing loan portfolio increase by 1%, the provision would be estimated higher by LVL 653 thousand (2007: LVL 700 thousand).

2 ACCOUNTING POLICIES (continued)

(26) Critical Accounting Estimates and Judgements (continued)

- Impairment on available for sale and held to maturity investments. The Group and the Bank determines that available for sale and held to maturity investments are impaired when the following criteria are met:
  - any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
  - the issuer experiences a significant financial difficulty as evidenced by the borrower's financial information that the Group obtains;
  - the issuer considers bankruptcy or a financial reorganisation;
  - there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower.
- Securities valued at fair value. The Group used quoted market prices to value securities carried at fair value as at year end for those securities which in the management's judgement are traded in active markets. The management had evaluated the activity of the Latvian securities market and has concluded that there is a significant reduction of activities in Latvian market, however, consider the market to be active with respect to type of securities held by the Group therefore quoted market prices available on Riga Stock Exchange were used to determine the fair values of the securities issued by Latvian issuers and traded on Riga Stock Exchange as at year end.
- Investment in AS "Parex banka" shares. To ensure the stability of the financial system of the country, on 8 November 2008 the Cabinet of Ministers of the Republic of Latvia took the decision to assign the Bank to take over the control of a/s „Parex banka" by acquisition of 51% of its shares for a price of LVL 2.00 (two lats). On 3 December 2008 the Cabinet of Ministers of the Republic of Latvia took the decision to assign the Bank to take over additional shares of a/s "Parex banka" becoming the owner of 84.83% of the shares. Thus the Bank is an instrument for ensuring realisation of the government objective of stabilisation of Latvian financial system and all significant operations relating to a/s "Parex banka" are made based on the Cabinet of Ministers decisions. Thus the control is effectively exercised by the state and therefore the investment in a/s "Parex banka" shares has been classified as investment in trading securities in accordance with IAS 39. A/s "Parex banka" shares are not quoted in active market and their fair value cannot be reliably measured therefore the investment is valued at cost (See Note 21).

(27) Adoption of new or revised standards and interpretations and new accounting pronouncements

Certain new IFRSs became effective for the Group from 1 January 2008. Listed below are those new or amended standards or interpretations which are relevant to the Group's operations and the nature of their impact on the Group's accounting policies.

IAS 39, 'Financial instruments: Recognition and measurement' and IFRS 7, 'Financial instruments: Disclosures' on the 'Reclassification of financial assets' (Effective for annual periods beginning or after 1 July 2008) - This amendment allows the reclassification of certain financial assets previously classified as 'held-for-trading' or 'available-for-sale' to another category under limited circumstances. Various disclosures are required where a reclassification has been made. Derivatives and assets designated as 'at fair value through profit or loss' under the fair value option are not eligible for this reclassification. Given the urgency of the issue, due process was suspended and there was no comment period. Amendment confirms that any reclassifications made on or after 1 November 2008 should take effect only from the date of the reclassification and may not be backdated. The Bank made reclassification in 2008, see Note 15.

NOTES TO THE FINANCIAL STATEMENTS

Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2009 or later periods and which are relevant to the Group but not early adopted by the Group.

IAS 1, 'Presentation of financial statements' (revised September 2007; effective for annual periods beginning on or after 1 January 2009) - The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income.

2 ACCOUNTING POLICIES (continued)

(27) Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)

The revised IAS 1 also introduces a requirement to present a statement of financial position at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to impact the presentation of its financial statements but to have no impact on the recognition or measurement of specified transactions and balances.

IAS 27, 'Consolidated and separate financial statements' (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss. The revised standard is not yet endorsed in EU. The group will apply IAS 27 (Revised) prospectively to transactions with non-controlling interests from the date it will become effective in EU. The Group and the Bank is currently assessing the impact of the amended standard on its financial statements.

IFRS 3, 'Business combinations' (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The revised standard is not yet endorsed in EU. The Group will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010 if the revised standard will become effective in EU until then. The Group is currently assessing the impact of the amended standard on its financial statements.

IFRS 8, 'Operating segments' (effective for annual periods beginning on or after 1 January 2009). IFRS 8 replaces IAS 14, Segment reporting. The Standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to the used for internal reporting purposes. The Group and the Bank is assessing the impact of the revised standard on the Group's and the Bank's financial statements.

Improvements to International Financial Reporting Standards (issued in May 2008).

NOTES TO THE FINANCIAL STATEMENTS

In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards.

The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest rate method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5;

2 ACCOUNTING POLICIES (continued)

(27) Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)

reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on the financial statements. The Group does not expect the amendments to have any material effect on the financial statements.

Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2009 or later periods and which are not relevant to the Group.

IAS 23, 'Borrowing costs' (revised March 2007; effective for annual periods beginning on or after 1 January 2009) - The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The standard will not have any impact on the Group’s and the Bank’s financial statements.

IFRS 2, 'Share-based payment' (issued in January 2008, effective for annual periods beginning on or after 1 January 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment will not have any impact on the Group’s and the Bank’s financial statements.

IAS 32, 'Financial instruments: Presentation', and IAS 1 (Amendment), 'Presentation of financial statements' – 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009). The amended standards requires classification as equity of some financial instruments that meet the definition of financial liabilities. The amendment will not have any impact on the Group’s consolidated financial statements.

IFRS 1 'First time adoption of IFRS' and IAS 27 'Consolidated and separate financial statements' (Amendment) (issued in May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendment will not have any impact on the Group’s consolidated financial statements.

IAS 39, Financial Instruments: Recognition and Measurement: Eligible Hedged Items (Amendment)(effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not yet endorsed in EU. The

NOTES TO THE FINANCIAL STATEMENTS

amendment will not have any impact on the Group's consolidated financial statements as the Group does not apply hedge accounting.

IFRIC 12, Service Concession Agreements (effective for annual periods beginning on or after 1 January 2008). – This interpretation applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services, for example, under private finance initiative contracts (PFI) contracts. Under these arrangements, assets are assessed as either intangible assets or finance receivables. The interpretation is not yet endorsed in EU. This interpretation will not have an impact on the Group's financial statements

2 ACCOUNTING POLICIES (continued)

(27) Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)

IFRIC 13, 'Customer loyalty programmes' (effective for annual periods on or after 1 July 2008; for entities applying IFRS as adopted in the EU effective for annual periods beginning after 31 December 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. This interpretation does not have an impact on the Group's financial statements.

IFRIC 14, 'IAS 19 (effective for annual periods beginning on or after 1 January 2008; for entities applying IFRS as adopted in the EU effective for annual periods beginning after 31 December 2008) – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. This interpretation does not have any impact on the Group's financial statements

IFRIC 15, 'Agreements for construction of real estates' (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The interpretation is not yet endorsed in EU. IFRIC 15 will not be relevant to the group's operations because it does not have any agreements for the construction of real estate.

IFRIC 16, 'Hedges of a net investment in a foreign operation' (effective for annual periods beginning on or after 1 October 2008). IFRIC 16 clarifies the accounting treatment in respect of net investment hedging. This includes the fact that net investment hedging relates to differences in functional currency not presentation currency, and hedging instruments may be held anywhere in the group. The requirements of IAS 21, 'The effects of changes in foreign exchange rates', do apply to the hedged item. The interpretation is not yet endorsed in EU. IFRIC 16 will not have any impact on these financial statements as the Group does not apply hedge accounting.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners.

*IFRIC 18**,** Transfers of Assets from Customers* (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not relevant to the Group's operations because it does not transfer assets from customers.

NOTES TO THE FINANCIAL STATEMENTS

3 RISK MANAGEMENT

The Group and the Bank manages all the major risks affecting the operation of the Group and the Bank in accordance with the Risk Management Policy approved by the Council of the Bank. The Risk Management Policy stipulates and describes the aggregate of measures used to ensure that a possibility of suffering losses is minimised in the event the invested or receivable resources would not be repaid or recovered in due time or full amount or the Group or the Bank would suffer other losses or would not derive the planned profit.
During the reporting period significant changes took place in the local and foreign financial markets therefore several risk management methods were implemented or improved in the Group and the Bank thus allowing to identify the risks more precisely and timely and to determine their impact on the future operations of the Group and the Bank . Majority of methods implemented relates to improvement of credit risk management, including the improvement of risk management with respect to individual client, groups of related clients and at the portfolio level. Development of risk management in the Group and the Bank in 2008 was also promoted by the Basel II requirements that determine the minimum capital requirements for all significant operational risks of the Group and the Bank as well as guidelines for their implementation.

The Group and the Bank abides by the following principles in its risk management:

- while assuming the risks the Group and the Bank shall be capable of implementing the aims and assignments defined in its development strategy in a longer run;
- the Group and the Bank shall operate by maintaining an optimum balance between profitability and safeguarding against the risks, i.e. the profitability must be as large as possible, however, the Group and the Bank shall not be exposed to the risks;
- risk assessment and management shall be an integral component of the every-day functions of the Group and the Bank;
- In accordance with their authority and competence the employees of the Group and the Bank shall know a customer and understand fully the nature of each transaction (operation) to be able to identify and assess the risks associated with the transaction (operation) and find the best solution both for the customer and the Group or the Bank;
- the Group and the Bank shall assess the probable losses that it might incur by assuming the risks and avoid extraordinary losses in its operation;
- the Group and the Bank shall identify and assess the probable risks before launching of new products or services or entering new markets;
- where necessary, the Group and the Bank shall reduce the risk limits, sell the assets subject to the risk or even leave the respective markets should these be assessed as excessively risky.

In managing the risks the Group and the Bank applies various methods for measuring the risks, sets the limits and maintains the appropriate controls. All risk policies are approved by the Council.

Credit Risk
The Group and the Bank is subject to the credit risk. The credit risk is the risk of the customer or co-operation partner not being able to or refusing to meet its liabilities towards the Group or the Bank in full amount and due time.
The Group and the Bank manages the credit risk according to the Credit Policy as well as internal regulations, procedures and instructions of credit operations.
The Credit Policy of the Bank describes and defines the principles for the management of the credit risk and it relates to all activities of the Group and the Bank involving credit risk – lending, financial market transactions

NOTES TO THE FINANCIAL STATEMENTS

(operations), intermediary activities on behalf of the clients and issue of guarantees to third parties.
The Bank's Risk Management Committee monitors the credit risk, including credit risk concentrations, and the quality of the credit portfolio, whereas central, regional and branch credit committees are taking decisions on the credit risk within the approved limits. The Bank's Risk Management Department is responsible for analysis of the credit risk concentration, setting and controlling the limits as well as the evaluation of the quality of the credit portfolio, whereas the Bank's Loan Department and Treasury Department is responsible for daily credit risk management in lending operations and operations with financial instruments respectively.
The Group and the Bank monitors the credit risk by assessing the creditworthiness and adequacy of collateral of the customer or counterparty on a regular basis as well as controls the credit risk at the level of customer, related customers and sectors of economy according to the risk limits set at the Group and the Bank. The Bank accepts a pledge of real estate, as well as business assets like buildings, stock and debtors as collateral.

3 RISK MANAGEMENT (continued)

During the reporting period the credit risk and required provisions level increased substantially and the Bank and Group continued to develop credit risk management policies. When providing for credit loss, the Bank and Group takes into consideration the following factors: paying capacity of the borrower, credit risk diminishing elements, such as collateral. The approach applied by the Bank and the Group implies that the Bank and the Group provides for credit loss in situations where neither the paying capacity, nor the collateral cover the borrower's liability or its part, which results in objective evidence for financial asset impairment.
The Bank and the Group maintains separate database for valuation of impaired financial assets in different dimensions such as split by geographical region, product type, industry etc. By collecting such data, the Bank and the Group ensures accumulation of information on losses incurred in different periods as well as develops its credit risk analysis and management policies. Since the historical data does not reflect the current level of credit risk, the Bank and the Group adjusts the data in accordance with Bank's and Group's expert assessment and statistical analysis. The Bank and the Group carries out stress tests and scenario analysis for different macroeconomic factor changes such as real estate price decrease, reduction in population income levels, potential changes in different industries etc..
The Group and the Bank manages credit risk concentrations according to the Risk Exposures Controlling Policy that stipulates the methods of analysis of the credit risk concentrations and its controlling instruments including limits on credit risk concentrations. Credit risk concentrations is managed by measuring and setting limits on the following concentrations:

- ratio of large exposure concentration and own funds (internal limit - 400%, limit set by the Law on Credit Institutions – 800%), as of 31.12.2008. was 78.6% (as of 31.12.2007.-79%);
- ratio of single client's (related clients' group) large exposure and own funds, which can not exceed 25%, as of 31.12.2008. was 22.1% (as of 31.12.2007.-16.6%);
- ratio of risk exposures with persons related to the Bank and own funds, which can not exceed 15%, as of 31.12.2008. was 3.8% (as of 31.12.2007.-6.1%).
- proportion of risk concentration in single economic sector in the Bank's credit portfolio and own funds as of 31.12.2008. was 172.56% (as of 31.12.2007.-195.9%);

Since the Bank's strategy is not focused on servicing the non-residents business, the proportion of the Bank's total claims to non-residents was small and as of 31.12.2008. was 8.9% (as 31.12.2007.–7.7%) of the Bank's total assets. The Group and the Bank manages the country risk that results from the lending operations to non-residents according to the Country Risk Management Policy. The Note 20 to these financial statements discloses the individually assessed loans of the Group and the Bank by risk classes.

Liquidity Risk

The liquidity risk relates to the ability of the Group and the Bank to redeem the legally valid claims of its customers and other creditors in due time and secure that the increase of the anticipated claims presents reasonable costs. The Liquidity Risk Management Policy of the Bank stipulates the principles for management of liquidity risk. The Bank shall ensure that the liquid assets are not less than 30% (set by the FCMC) of its short-term liabilities at all times. The Assets and Liabilities Committee of the Bank stipulates the guidelines for liquidity risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the liquidity risk. To evaluate the liquidity risk, the Bank uses the GAP method. The Bank has set liquidity net position limit in each significant currency and total liquidity net position limit as well as maximum deposit amount from a single depositor to control the liquidity risk. Liquidity ratio (min – 30%) as of 31.12.2008. 60.4% (as of 31.12.2007.-99.4%). The Note 40 to these financial statements discloses the liquidity ratios of the Group and the Bank as at 31 December 2008.

NOTES TO THE FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS

3 RISK MANAGEMENT (continued)

Foreign Currency Risk

The foreign currency risk occurs due to the differences between the asset and liability positions of foreign currencies that, as a result of the fluctuations of the exchange rates, affect the cash flow and financial results of the Group and the Bank. The Currency Risk Management Policy of the Bank stipulates the principles for the management of the foreign currency risk.

The Group and the Bank controls the foreign currency risk by imposing limits on the open currency positions for each currency and all currencies together consolidating in lats and by complying with the open currency position limits established in the law On Credit Institutions.

The Assets and Liabilities Committee of the Bank stipulates the guidelines for foreign currency risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the foreign currency risk. The Note 42 to these financial statements discloses the open currency positions of the Group and the Bank by currencies as at 31 December 2008.

Interest Rate Risk

The interest rate risk is related to the influence of the fluctuations of the market rates onto the interest income and expenses of the Group and the Bank. To assess the interest rate risk the Bank analyses the maturity structure of the assets and liabilities sensitive to the changes in interest rates and susceptibility of the maturity structure to the potential fluctuations of the interest rates on a regular basis.

The Assets and Liabilities Management Committee monitors the interest rate risk, whereas the Treasury Department is responsible for the daily management of the interest rate risk. The Bank has set limit on changes in economic value of the Bank at 10% of own funds and limit on changes in net interest income at 2% of own funds which as of 31.12.2008. were 9.76% (as of 31.12.2007.-7.96%) and 0.27% (as of 31.12.2007.-0.93%) respectively. The Note 41 to these financial statements discloses the Group's and the Bank's assets and liabilities by re-pricing maturity.

Operational risk

The operational risk results from intentional or unintentional deviations from the standards adopted in daily operation of the Group and the Bank, for example human mistake or fraud, disturbances in the operation of the information systems, insufficient control procedures or their ignorance. The Group and the Bank manages operational risk according to the Operational Risk Management Policy. The Internal Control System provides for management and control of the operational risk in the Group and the Bank. The Group and the Bank uses self-assessment method to measure the operational risk, whereas the Bank's operational risk information system is used to identify, analyse and control the operational risk. The structural units of the Group and the Bank are responsible for the management of the operational risk in the daily operations, but the Risk Management Committee monitor the operational risk. The Risk Management Department is responsible for the implementation of operational risk management in the Group and the Bank.

The Bank has implemented Business continuity plan that includes guidelines on actions to be taken by the Bank, its structural units and employees at occurrence of risks that can have substantial negative effect on the Bank's operations.

Capital Adequacy

Capital adequacy shows those capital resources of the Group and the Bank needed to cover the credit and market risks arising from asset-side and off-balance sheet positions.

As of 1 January 2008 new European Union capital adequacy calculation regulations (Basel II) came into force. The Group and the Bank uses the standardised approach to calculate minimum capital charge for credit and market risks and basic indicator approach – for operational risk.

As at 31 December 2008 the capital adequacy ratio of the Bank calculated according to the regulations of the Financial and Capital Market Commission were 9.6% (as of 31.12.2007.-9.9%) which exceeded the minimum of 8%. The Note 43 to these financial statements discloses the Group's and the Bank's capital adequacy calculation.

NOTES TO THE FINANCIAL STATEMENTS

3 RISK MANAGEMENT (continued)

The Group and the Bank has carried out also internal capital adequacy evaluation where in addition capital requirements for those significant risks with respect to which no minimum capital requirements have been determined by the regulation have been taken into account. Internal capital adequacy evaluation results as at 31 December 2008 were as follows:

	31/12/08	
	Group	**Bank**
Capital base for internal capital adequacy evaluation	84,819	84,822
Internal capital requirement	80,613	78,654
Internal capital adequacy ratio	8.4%	8.6%
Surplus of capital base	4,206	6,167

4 REPORT ON CORPORATE GOVERNANCE

The corporate governance of Mortgage Bank is based on the international standards, the best corporate governance practice and laws of the Republic of Latvia.

The daily routine of the Mortgage Bank complies with high standards of corporative governance. The Mortgage Bank constantly works on the improvement of its corporate governance.

The purpose of the corporate governance is to establish, maintain and continuously develop the operational systems that ensure meeting of the targets that the government of the Republic of Latvia has set for the Mortgage Bank, control over operations and management of the operational risks while taking care of customer satisfaction and sustaining good co-operation with the business partners.

Within the framework of corporate governance the Mortgage Bank implements:

- protection of the rights and securing of the interests of the investors, customers and other related parties;
- timely and adequate provision of information about the operations and financial performance and other important events of the Mortgage Bank;
- compliance with generally adopted code of ethics;
- protection of the rights and securing of the interests of the shareholder.

The Mortgage Bank has elaborated and implemented an effective internal control system over the operations of the Bank incorporating the management system of the operational risks of the Bank. The Council and Board of the Bank examine the efficiency of the internal control system on a regular basis, supervise and ensure its constant improvement in line with the changes in the operations of the Mortgage Bank and internal and external circumstances affecting the operations of the Bank.

The internal control system identifies and defines responsibility for maintaining efficient functioning of the specific components of the internal control system by listing the duties and obligations of the shareholder, Council, Board, special committees established by Board, structural units and employees.

In view of the importance of such a component of corporate governance as independent evaluation and control of the financial standing of the Bank, the Council and Board of the Bank guarantee that regarding the drawing up of the financial reports the internal control system gives a true and accurate representation of the operations and financial standing of the Bank.

Within the framework of the internal control system the control processes have been elaborated and documented. The control processes comprise: control over daily operations, supervision and control of drafting of the financial reports and information to be included therein, including independent supervision and control by internal audit, audit committee, external audit and other control institutions.

NOTES TO THE FINANCIAL STATEMENTS

4 REPORT ON CORPORATE GOVERNANCE (continued)

The Mortgage Bank is fully owned by the state of Latvia. The Bank is supervised by the Ministry of Finance of the Republic of Latvia that represents the interests of the shareholder on behalf of the Cabinet of Ministers of the Republic of Latvia and holds 100% of the shares of the Bank.

The Articles of Association of the state-owned JSC "Mortgage and Land Bank of Latvia" govern the election of the Board members and changes to the composition of the Board and mandate of the Board members. The Articles of Association are published on the homepage of the Mortgage Bank. The procedure for making changes to the Articles of Association is governed by the laws of the Republic of Latvia. Once the changes to the Articles of Association are made they are published on the home page of the Bank.

NOTES TO THE FINANCIAL STATEMENTS

5 INTEREST INCOME

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Interest income:				
- Interest on balances due from credit institutions	6,334	6,327	4,247	4,247
- interest on loans to customers	55,064	52,517	45,196	42,723
- interest on investments in securities	4,708	4,702	3,004	3,004
	66,106	**63,546**	**52,447**	**49,974**
Cash flow from interest received	64,147	61,573	50,428	48,019

6 INTEREST EXPENSE

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Interest expense:				
- interest on balances due to credit institutions	27,506	26,632	17,008	16,577
- interest on current and deposit accounts	12,781	12,784	9,451	9,705
- interest on transit funds	153	153	148	148
- interest on subordinated liabilities	1,637	1,637	777	777
- interest on mortgage bonds issued	2,805	2,805	2,705	2,705
- other interest expense	53	53	49	49
	44,935	**44,064**	**30,138**	**29,961**
Cash flow from interest paid	42,008	41,333	28,081	27,967

7 FEE AND COMMISSION INCOME

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Fee and commission income:				
- from lending activities	1,325	1,259	1,673	1,625
- from money transfers and account servicing	1,554	1,558	1,409	1,458
- from payment cards	982	982	816	816
- from securities accounts	66	66	72	72
- from insurance fiduciary activities	87	87	93	83
- other fee and commission income	77	54	49	49
	4,091	**4,006**	**4,112**	**4,103**

8 FEE AND COMMISSION EXPENSE

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Fee and commission expense:				
- for account services	213	200	226	225
- for payment cards	604	604	512	512
- for transactions with securities	89	87	53	53
- other fee and commission expense	91	81	133	70
	997	**972**	**924**	**860**

NOTES TO THE FINANCIAL STATEMENTS

9 NET TRADING INCOME

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Profit from trading securities	250	260	292	292
Profit from dealing with currency exchange and revaluation of foreign currency positions	1,906	1,924	1,850	1,819
	2,156	**2,184**	**2,142**	**2,111**

10 OTHER OPERATING INCOME

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Income from property privatisation services	329	329	390	390
Penalty fees received on overdue loan repayments	1,285	816	662	395
Compensations	761	761	742	742
Operating lease income	231	-	621	-
Recovery of loans written off in the previous periods	961	961	1,198	1,180
Other	1,200	573	594	422
	4,767	**3,440**	**4,207**	**3,129**

11 STAFF COSTS

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Remuneration to the Council and the Board	613	445	507	416
Remuneration to staff members	7,686	6,957	7,713	7,035
Social security contributions	1,799	1,593	1,816	1,645
	10,098	**8,995**	**10,036**	**9,096**

During the reporting year the Bank employed on average 667 staff members (2007: 641).

12 ADMINISTRATIVE AND OTHER OPERATING EXPENSES

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Training and other staff expense	593	554	578	559
Equipment and premises maintenance expense	2,693	2,500	2,270	2,072
Information system and communication expense	1,819	1,716	1,548	1,474
Advertising and public relations	1,462	1,299	1,971	1,789
Professional services	436	431	427	444
Property tax	58	58	62	62
Write off of fixed assets	55	34	7	7
Payments to the deposit guarantee fund	452	452	508	508
Revaluation of investment properties	290	290	138	138
Other expenses	1,293	780	911	610
	9,151	**8,114**	**8,420**	**7,663**

NOTES TO THE FINANCIAL STATEMENTS

13 PROVISION FOR IMPAIRMENT LOSSES

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Provision expense:				
- provisions for loans	7,886	7,331	4,131	3,748
- provisions for other assets	360	180	155	155
- provisions for securities	1,885	1,885	-	-
- provisions for off balance sheet liabilities	30	30	4	4
	10,161	**9,426**	**4,290**	**3,907**
Release of provision:				
- provisions for loans	(838)	(838)	(955)	(947)
- provisions for other assets	(43)	(43)	(67)	(67)
- provisions for off balance sheet liabilities	-	-	(43)	(43)
	(881)	**(881)**	**(1,065)**	**(1,057)**
Total provision for impairment losses - expense	**9,280**	**8,545**	**3,225**	**2,850**

14 CORPORATE INCOME TAX

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Income tax	111	-	1,119	897
Deferred tax (see Note 29)	43	70	64	46
	154	**70**	**1,183**	**943**

Corporate income tax differs from the theoretically calculated tax amount that would arise applying the 15% rate stipulated by the law to profit before taxation:

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
Profit before tax	**335**	**1,277**	**7,698**	**7,089**
Tax calculated at 15%	50	192	1,155	1,063
Donations and gifts relief	-	-	(161)	(161)
Dividends received	-	(122)	-	-
Expenses not deductible for tax purposes, net	104	-	189	41
Tax expense for the year ended 31 December	**154**	**70**	**1,183**	**943**

15 CASH AND BALANCES WITH CENTRAL BANK

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Cash	9,184	9,184	7,374	7,374
Balances with the Bank of Latvia	35,931	35,931	58,891	58,891
	45,115	**45,115**	**66,265**	**66,265**

NOTES TO THE FINANCIAL STATEMENTS

15 CASH AND BALANCES WITH CENTRAL BANK (continued)

The correspondent account with the Bank of Latvia reflects the balance of the Bank's correspondent account, on which interest is paid in the amount of the compulsory reserve requirement.

The Bank is required to comply with minimum reserve requirements set by the Bank of Latvia. This requires the Bank's monthly average LVL balance on its correspondent account with the Bank of Latvia to exceed a specified minimum during the maintenance period of requirements.

The Bank was in compliance with the reserve requirement during the reporting period.

16 TRADING AND INVESTMENT SECURITIES

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Trading securities				
Latvian Treasury bills and government bonds	2,150	2,150	-	-
Non-OECD government bonds	-	-	619	619
Latvian corporate bonds	1,112	1,112	453	453
OECD corporate bonds	344	344	1,275	1,275
Non-OECD corporate bonds	46	46	712	712
Equity shares in Latvian corporate entities	41	41	100	100
Equity shares in OECD corporate entities	18	15	80	80
Equity shares in non-OECD corporate entities	-	-	30	30
Other investment	148	3	-	-
Total trading securities	**3,859**	**3,711**	**3,269**	**3,269**
Securities held to maturity				
Latvian Treasury bills and government bonds	101	-	-	-
OECD government bonds	1,263	1,263	-	-
Non-OECD government bonds	9,158	9,158	35	35
OECD corporate bonds	24,522	24,522	-	-
Non-OECD corporate bonds	14,718	14,718	-	-
Latvian corporate bonds	16,164	16,164	13,025	13,025
Total securities held to maturity	**65,926**	**65,825**	**13,060**	**13,060**
Securities available-for-sale				
Latvian Treasury bills and government bonds	26,296	26,296	13,342	13,342
OECD government bonds	-	-	2,040	2,040
Non-OECD government bonds	-	-	8,586	8,586
OECD corporate bonds	-	-	16,034	16,034
Non-OECD corporate bonds	-	-	12,710	12,710
Latvian corporate bonds	-	-	1,419	1,419
Total securities available-for-sale	**26,296**	**26,296**	**54,131**	**54,131**
Provisions for impairment losses on securities	(1,856)	(1,856)	-	-
Total net trading and investment securities	**94,225**	**93,976**	**70,460**	**70,460**

In the reporting period the Bank established an impairment provision of LVL 1,856 thousand for American investment bank Lehman Brothers bonds and Iceland banks bonds. The amount of the provision was established based on the management's estimates made with respect to recoverable amount. As at 31 December 2008 the gross value of Lehman Brothers and Iceland banks bonds was LVL 3,336 thousand.

NOTES TO THE FINANCIAL STATEMENTS

16 TRADING AND INVESTMENT SECURITIES (continued)

Reclassified amounts are provided in the table below:

Reclassified from / to	Reclassified financial assets	Fair value on date of reclassification
Reclassified from *trading* to *held to maturity*	Bonds	2,562
Reclassified from *available for sale to held to maturity*	Bonds	48,206
Total		**50,768**

If no reclassification of available for sale securities was made as of 1 July 2008, the revaluation deficit on available for sale investments included in equity as at 31 December 2008 would be LVL 7,226 thousand.

The following table shows the division of the Bank's debt securities by rating agency designation (*Moody`s investors Service*) as at 31 December 2008:

	Trading securities	Investment securities available-for-sale	Securities held to maturity	Total net
Aaa	-	-	486	**486**
Aa1 - Aa3	293	-	10,345	**10,638**
A1 - A3	-	-	11,039	**11,039**
Baa1 - Baa3	2,150	26,296	12,736	**41,182**
Lover than Baa3	329	-	22,225	**22,554**
Unrated	880	-	8,994	**9,874**
Total	**3,652**	**26,296**	**65,825**	**95,773**

The following table shows the division of the Bank's debt securities by rating agency designation (*Moody`s Investors Service*) as at 31 December 2007:

	Trading securities	Investment securities available-for-sale	Securities held to maturity	Total net
Aaa	554	975	-	**1,529**
Aa1 - Aa3	369	8,114	-	**8,483**
A1 - A3	352	24,535	-	**24,887**
Baa1 - Baa3	450	11,534	-	**11,984**
Lover than Baa3	1,081	8,223	1,797	**11,101**
Unrated	253	750	11,263	**12,266**
Total	**3,059**	**54,131**	**13,060**	**70,250**

All securities are quoted on stock exchange. The average yield on investment securities as at 31 December 2008 was 7.9% (2007: 6.6%).

17 INVESTMENT PROPERTIES

	31/12/2008		31/12/2007	
	Group	Bank	Group	Bank
Carrying amount at 1 January	**2,116**	**2,116**	**2,253**	**2,253**
Loss on fair valuation	(290)	(290)	(137)	(137)
Carrying amount at 31 December	**1,826**	**1,826**	**2,116**	**2,116**

NOTES TO THE FINANCIAL STATEMENTS

17 INVESTMENT PROPERTIES (continued)

Investment properties include real estate at Jēkaba iela 6/8, Riga, with a carrying amount of LVL 1,826 thousand as at 31 December 2008 (LVL 2,116 thousand as at 31 December 2007). Investment properties are held at fair value based on valuations made by independent valuers who have up-to-date experience in valuing real estate in the respective location and category and who hold an appropriate professional qualification for real estate valuation. The valuations are made on the basis of recent comparative data in the local market and/or on the basis of rental returns discounted at an appropriate rate.

18 DUE FROM CREDIT INSTITUTIONS

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Due from credit institutions registered in OECD countries	5,487	5,487	14,555	14,555
Due from credit institutions registered in Latvia	48,100	47,847	76,537	76,328
Due from credit institutions registered in other countries	12,000	12,000	13,779	13,779
	65,587	**65,334**	**104,871**	**104,662**

When lending to monetary financial institutions and setting limits for money market and transactions and nostro accounts, the Bank carries out analysis of external credit ratings assigned to correspondent banks and credit institutions as well as assesses their financial and operating performance. During the cooperation period the Bank monitors the performance of correspondent banks and monetary financial institutions and follows up on appropriateness of the limits set in the light of the credit risk assessment. In order to ensure efficient and constructive monitoring of counterparties, the Bank assigns a rating to each counterparty from A (highest) to D (lowest): A – financial performance of the counterparty is stable and the paying capacity is assessed as good in the economic conditions, B – the financial performance of the counterparty is weakening or can lead to potentially serious financial problems in the future, C – the counterparty has serious financial problems that threaten its stability and paying capacity in accordance with the Bank's assessment, D – the counterparty in insolvent or bankrupt in accordance with the information available to the Bank.

The balances due to banks by credit quality of the Bank as at 31 December 2008 is as follows:

	A	**B**	**C**	**D**	**Total**
Due from credit institutions registered in OECD countries	5,296	191	-	-	**5,487**
Due from credit institutions registered in Latvia	27,099	8,844	11,904	-	**47,847**
Due from credit institutions registered in other countries	10,492	1,008	500	-	**12,000**
Total	**42,887**	**10,043**	**12,404**	**-**	**65,334**

NOTES TO THE FINANCIAL STATEMENTS

18 DUE FROM CREDIT INSTITUTIONS (continued)

The balances due to banks by credit quality of the Bank as at 31 December 2007 is as follows:

	A	B	C	D	Total
Due from credit institutions registered in OECD countries	14,555	-	-	-	**14,555**
Due from credit institutions registered in Latvia	74,079	2,249	-	-	**76,328**
Due from credit institutions registered in other countries	12,069	1,710	-	-	**13,779**
Total	**100,703**	**3,959**	**-**	**-**	**104,662**

At 31 December 2008 the Bank had correspondent accounts with 18 banks (2007: 19 banks).

The average interest rate on balances due from credit institutions as at 31 December 2008 was 4.5% (2007: 5.5%).

19 DERIVATIVE FINANCIAL INSTRUMENTS

The Group and the Bank use the following derivative financial instruments: currency forwards representing commitments to purchase foreign and domestic currency, currency swaps representing commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies.

The Group's and the Bank's credit risk represents the potential cost to replace the forward or swap contracts if counterparties fail to perform their obligation. To control the level of credit risk taken, the Group and the Bank assesses counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and do not indicate the Group's and the Bank's exposure to credit risks. The derivative instruments become favourable or unfavourable as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms.

The Group's notional amounts and fair values of derivative instruments held for trading are set out in the following table:

	31/12/08			**31/12/07**		
	Contract / notional amount	**Fair value**		**Contract / notional amount**	**Fair value**	
		Assets	**Liabilities**		**Assets**	**Liabilities**
Currency swaps	114,828	1,569	522	14,509	84	117
Currency forwards	1,456	12	24	504	-	13
Total		**1,581**	**546**		**84**	**130**

NOTES TO THE FINANCIAL STATEMENTS

20 LOANS TO CUSTOMERS

Loans by type of borrower:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Central governments	-	-	7,040	7,028
Local government	1,896	1,530	2,179	1,688
State owned companies	2,934	2,934	2,353	2,353
Financial institutions	485	77,145	414	85,186
Private companies	511,718	431,919	428,055	348,549
Individuals	222,586	211,168	222,736	211,256
Management / staff	7,919	6,216	6,853	5,708
Public and religious institutions	690	674	714	684
Total gross loans	**748,228**	**731,586**	**670,344**	**662,452**
Accrued interest on loans	4,418	4,462	2,520	2,550
Provisions for impairment losses on loans	(10,260)	(9,473)	(5,006)	(4,652)
Total net loans	**742,386**	**726,575**	**667,858**	**660,350**

97.8% from loans issued by the Bank and the Group are loans to Latvia residents.

Economic sector risk concentrations within the customer loan portfolio are as follows:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Agriculture and forestry	100,993	85,080	90,868	80,105
Fishing	4,545	4,460	5,536	5,430
Manufacturing	95,418	82,529	68,877	56,652
Electricity, gas and water utilities	7,211	7,130	7,818	7,687
Construction	35,580	31,004	15,615	9,706
Retail trade and wholesale distribution	63,859	50,944	50,019	39,347
Hotels and restaurants	25,094	24,613	17,860	17,396
Transport, warehousing and communications	42,355	17,444	43,641	15,082
Financial intermediaries	851	77,216	9,079	93,671
Real estate	88,076	88,028	96,886	97,192
Municipal authorities	1,896	1,530	9,227	8,716
Individuals	230,505	217,384	229,589	216,964
Other industries	51,845	44,224	25,329	14,504
Total gross loans	**748,228**	**731,586**	**670,344**	**662,452**

The extent of loan and advance concentration with respect to individual non-bank customers with total credit exposures equal to or exceeding Ls 1,000 thousand is presented below:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Number of customers	74	76	57	57
Total credit exposure of customers	184,029	260,659	136,125	219,579
Percentage of total gross portfolio of loans	24.6%	35.6%	20.3%	33.2%

At 31 December 2008 the top ten borrowers represented 9.3% (8.3% at 31 December 2007) of the total loan portfolio.

NOTES TO THE FINANCIAL STATEMENTS

20 LOANS TO CUSTOMERS (continued)

The Latvian banking legislation requires that any credit exposure to a non-related entity or group of non-related entities may not exceed 25% of a credit institution's equity and the total credit exposure to all related parties may not exceed 15% of equity. The Latvian Financial and Capital Market Commission has agreed that these limits are not applicable to the Bank's credit exposure to its fully owned leasing subsidiary SIA Hipolīzings.

As at 31 December 2008, the Bank was in compliance with the legal requirement set for the total amount of non-zero risk credit exposure.

Analysis of loans by type of valuation and by risk groups of the Bank:

	31/12/08 Bank			31/12/07 Bank		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Individually assessed loans						
Standard	30,907	348,074	378,981	40,012	312,306	352,318
Watch list	7,161	34,122	41,283	998	5,825	6,823
Below standard	1,468	6,325	7,793	370	4,522	4,892
Doubtful	622	1,501	2,123	-	701	701
Lost	-	-	-	-	181	181
Provisions for impairment losses on loans	(2,304)	(4,529)	(6,833)	(273)	(2,633)	(2,906)
Individually assessed loans, net	**37,854**	**385,493**	**423,347**	**41,107**	**320,902**	**362,009**
Loans assessed on a group basis						
Homogenous groups of loans	178,621	127,247	305,868	176,488	123,599	300,087
Provisions for impairment losses on loans	(1,119)	(1,521)	(2,640)	(664)	(1,082)	(1,746)
Loans assessed on a group basis, net	**177,502**	**125,726**	**303,228**	**175,824**	**122,517**	**298,341**
Total net loans	**215,356**	**511,219**	**726,575**	**216,931**	**443,419**	**660,350**

Analysis of loans by type of valuation and by risk groups of the Group:

	31/12/08 Group			31/12/07 Group		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**

NOTES TO THE FINANCIAL STATEMENTS

Individually assessed loans						
Standard	30,907	269,309	300,216	40,012	225,718	265,730
Watch list	7,161	34,122	41,283	998	5,825	6,823
Below standard	1,468	5,461	6,929	370	3,607	3,977
Doubtful	622	1,501	2,123	-	701	701
Lost	-	-	-	-	181	181
Provisions for impairment losses on loans	(2,304)	(4,529)	(6,833)	(273)	(2,633)	(2,906)
Individually assessed loans, net	37,854	305,864	**343,718**	41,107	233,399	**274,506**
Loans assessed on a group basis						
Homogenous groups of loans	**191,860**	**210,235**	402,095	**189,263**	**206,189**	395,452
Provisions for impairment losses on loans	(1,226)	(2,201)	(3,427)	(711)	(1,389)	(2,100)
Loans assessed on a group basis, net	190,634	208,034	**398,668**	188,552	204,800	**393,352**
Total net loans	228,488	513,898	**742,386**	229,659	438,199	**667,858**

20 LOANS TO CUSTOMERS (continued)

The following table provides the division of loans and advances to customers by quality (Bank):

	31/12/08 Bank			**31/12/07 Bank**		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Neither past due nor impaired	168,452	411,120	579,572	190,846	411,484	602,330
Past due but not impaired	31,879	75,139	107,018	23,925	25,181	49,106
Impaired	18,448	31,010	49,458	3,097	10,469	13,566
Total loans	**218,779**	**517,269**	**736,048**	**217,868**	**447,134**	**665,002**
Provisions for impairment losses on loans	(3,423)	(6,050)	(9,473)	(937)	(3,715)	(4,652)
Total net loans	**215,356**	**511,219**	**726,575**	**216,931**	**443,419**	**660,350**

Accrued interest on impaired loans as at 31/12/2008 is LVL 1,372 thousand (LVL 348 thousand as at 31/12/2007)

The following table provides the division of loans and advances to customers by quality (Group):

	31/12/08 Group			**31/12/07 Group**		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Neither past due nor impaired	180,149	394,432	574,581	201,629	388,626	**590,255**
Past due but not impaired	32,878	87,393	120,271	25,696	38,826	**64,522**
Impaired	18,991	38,803	57,794	3,318	14,769	**18,087**
Total loans	**232,018**	**520,628**	**752,646**	**230,643**	**442,221**	**672,864**
Provisions for impairment losses on loans	(3,530)	(6,730)	(10,260)	(984)	(4,022)	**(5,006)**
Total net loans	**228,488**	**513,898**	**742,386**	**229,659**	**438,199**	**667,858**

The following table provides fair values of collaterals of loans past due for more than 30 days and with outstanding balances exceeding Ls 100 thousand:

NOTES TO THE FINANCIAL STATEMENTS

	31/12/08 Group	31/12/08 Bank	31/12/07 Group	31/12/07 Bank
Loans past due for more than 30 days and outstanding balances exceeding Ls 100 thousand	59,043	59,043	12,614	12,614
Fair value of collateral	**62,208**	**62,208**	**16,981**	**16,981**

Analysis of movement in provisions for loan impairment losses:

	31/12/08 Group	31/12/08 Bank	31/12/07 Group	31/12/07 Bank
As at beginning of the year	5,006	4,652	3,599	3,599
Increase of provisions	7,886	7,331	4,131	3,748
Release from provisions	(838)	(838)	(955)	(947)
Adjustment (foreign exchange fluctuation)	2	2	(33)	(33)
Write-off of loans	(1,796)	(1,674)	(1,736)	(1,715)
As at end of the year	**10,260**	**9,473**	**5,006**	**4,652**

20 LOANS TO CUSTOMERS (continued)

Maturity profile (Bank):

	31/12/08 Bank			31/12/07 Bank		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Overdue	2,346	7,408	9,754	620	1,757	2,377
Falling due within:						
1 month	2,178	16,665	18,843	6,011	10,496	16,507
1 – 3 months	5,421	21,270	26,691	2,245	22,064	24,309
3 – 6 months	3,856	39,568	43,424	3,739	43,694	47,433
6 –12 months	9,083	55,448	64,531	8,135	44,989	53,124
1 – 5 years	51,934	186,629	238,563	52,051	148,840	200,891
more than 5 years	143,961	190,281	334,242	145,067	175,294	320,361
Total loans	**218,779**	**517,269**	**736,048**	**217,868**	**447,134**	**665,002**
Less provision for loan impairment loss	(3,423)	(6,050)	(9,473)	(937)	(3,715)	(4,652)
Total net loans to customers	**215,356**	**511,219**	**726,575**	**216,931**	**443,419**	**660,350**

Maturity profile (Group):

	31/12/08 Group			31/12/07 Group		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**

NOTES TO THE FINANCIAL STATEMENTS

Overdue	2,454	8,684	11,138	696	2,396	3,092
Falling due within:						
1 month	2,413	17,558	19,971	6,208	12,134	18,342
1 – 3 months	5,931	24,608	30,539	3,097	27,947	31,044
3 – 6 months	4,254	42,599	46,853	4,452	49,137	53,589
6 –12 months	10,748	65,146	75,894	9,996	54,504	64,500
1 – 5 years	61,516	169,658	231,174	59,968	202,474	262,442
more than 5 years	144,702	192,375	337,077	146,226	93,629	239,855
Total loans	**232,018**	**520,628**	**752,646**	**230,643**	**442,221**	**672,864**
Less provision for loan impairment loss	(3,530)	(6,730)	(10,260)	(984)	(4,022)	(5,006)
Total net loans to customers	**228,488**	**513,898**	**742,386**	**229,659**	**438,199**	**667,858**

The following table provides the division of loans and advances to customers past due but not impaired:

	31/12/08 Bank			**31/12/07 Bank**		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Past due up to 30 days	18,551	41,846	60,397	17,641	21,574	39,215
Past due 30-60 days	7,478	16,983	24,461	5,403	2,589	7,992
Past due 60-90 days	3,000	12,045	15,045	831	1,018	1,849
Past due over 90 days	2,850	4,265	7,115	50	-	50
Total loans	**31,879**	**75,139**	**107,018**	**23,925**	**25,181**	**49,106**

20 LOANS TO CUSTOMERS (continued)

The following table provides the division of loans and advances to customers past due but not impaired:

	31/12/08 Group			**31/12/07 Group**		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
Past due up to 30 days	19,550	54,100	73,650	19,412	32,870	52,282
Past due 30-60 days	7,478	16,983	24,461	5,403	4,938	10,341
Past due 60-90 days	3,000	12,045	15,045	831	1,018	1849
Past due over 90 days	2,850	4,265	7,115	50	-	50
Total loans	**32,878**	**87,393**	**120,271**	**25,696**	**38,826**	**64,522**

The loans to customers include finance lease receivables. As at 31 December 2008 finance lease receivables may be analysed as follows:

	31/12/08 Group	**31/12/07 Group**
Falling due within:		
1 month	1,860	2,518
1 – 3 months	4,018	4,200
3 – 6 months	5,893	5,850
6 –12 months	11,937	11,715

NOTES TO THE FINANCIAL STATEMENTS

1 – 5 years	52,803	58,976
more than 5 years	2,644	3,675
Total	**79,155**	**86,934**

Finance leases by type of leased assets:

	31/12/07 Group	31/12/06 Group
Manufacturing and agricultural equipment	18,192	15,379
Transport vehicles	60,963	71,555
Total	**79,155**	**86,934**

The average interest rate for the loan portfolio as at 31 December 2008 was 7.8% per annum (7.5% at 31 December 2007).

21 INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED ENTITIES

The Bank's direct investments in subsidiaries and associated entities are specified as follows:

	Share capital	Total equity	Bank's share (%)	Investment value 31/12/08	Investment value 31/12/07
SIA "Hipolīzings"	645	908	100%	300	300
SIA "Hipotēku bankas nekustamā īpašuma aģentūra"	50	448	100%	50	50
SIA „Risku investīciju sabiedrība"	500	512	100%	500	500
KS „Mazo un vidējo komersantu atbalsta fonds"	101	95	47.62%	48	72
Total				**898**	**922**

21 INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED ENTITIES (continued)

The consolidation group also includes the following entities: IPS „Hipo Fondi" (87% owned by SIA „Risku investīciju sabiedrība"), SIA „Rīgas centra namu pārvalde" (100% owned by SIA „Risku investīciju sabiedrība"), SIA Rapsis (100% owned by SIA „Hipotēku bankas nekustamā īpašuma aģentūra").

On 8 November 2008 the Cabinet of Ministers of the Republic of Latvia in order to ensure the stability of the financial system instructed the Bank to take over the control of a/s „Parex banka", one of the largest private banks in Latvia. Based on the decision taken by the government the agreement was concluded between the Ministry of Finance, the Bank and a/s „Parex banka" on transfer of controlling interests in a/s „Parex banka" to state and transfer of 84.83% of shares to the Bank for the total purchase consideration of LVL 2 (two).

Taking into account the short term nature of the investment and the operating specifics thereto the investment has been included by the Bank in the balance sheet item „Trading securities" at fair value that equals its cost, i.e., LVL 2 (two). The investment in a/s „Parex banka" shares has no influence on the Bank's operations and it does not increase the risks undertaken by the Bank. (See also Note 2(26)).

For regulatory reporting purposes, the Bank has received permission from the Financial and Capital Market Commission not to include a/s „Parex banka" in the consolidation group of the Bank.

22 INTANGIBLE ASSETS

The following is included in the net book value of intangible assets:

NOTES TO THE FINANCIAL STATEMENTS

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Computer software	2,030	1,942	2,018	1,927
Goodwill arising on acquisition	404	-	-	-
Total intangible assets	**2,434**	**1,942**	**2,018**	**1,927**

The following table presents movements in the Group's and the Bank's net book value of compute software:

	Group	**Bank**
Historical cost		
As at 1 January 2008	**4,464**	**4,333**
Additions	536	514
As at 31 December 2008	**5,000**	**4,847**
Accumulated depreciation		
As at 1 January 2008	**2,446**	**2,406**
Charge for the period	524	499
As at 31 December 2008	**2,970**	**2,905**
Net book value as at 31 December 2007	**2,018**	**1,927**
Net book value as at 31 December 2008	**2,030**	**1,942**

Intangible assets include goodwill of LVL 404 thousand that arose in the result of acquisition by the Bank's subsidiary SIA „Riska investīciju sabiedrība" of 87% of IPS „Suprema Fondi" and 100% of SIA „Rīgas centra namu pārvalde" shares. The purchase consideration paid to acquire the above mentioned shares were LVL 450 thousand and LVL 150 thousand respectively. After acquisition IPS „Suprema Fondi" was renamed to IPS „Hipo Fondi".

22 INTANGIBLE ASSETS (continued)

The amounts recognised at the acquisition date for IPS „Suprema Fondi" und SIA „Rīgas centra namu pārvalde" assets, liabilities and contingent liabilities were as follows.

	IPS "Suprema fondi"	SIA "Rīgas centru namu pārvalde"
Assets		
Due from credit institutions	166	3
Property and equipment	-	37
Debtors	-	64
Other assets	1	22
Prepayments and accrued income	1	-
Total assets	**168**	**126**
Liabilities		
Creditors	-	55
Accrued expense and prepaid income	9	7
Equity	159	64
Total equity and liabilities	**168**	**126**

The movements in the balance of goodwill of the Group during the period are as follows:

	2008
	Group

NOTES TO THE FINANCIAL STATEMENTS

At 1 January	-
Goodwill recognised upon acquisition of IPS „Suprema Fondi”	318
Goodwill recognised upon acquisition of SIA „Rīgas centru namu pārvalde”	86
At 31 December	**404**

23 PROPERTY AND EQUIPMENT

The following table shows changes in property and equipment of the Bank in 2008:

	Land and buildings	Vehicles	Equipment	Leasehold improvements	Total
Cost					
As at 1 January 2008	**4,092**	**1,112**	**8,818**	**1,459**	**15,481**
Additions	19	141	1,031	64	1,255
Disposals	-	(237)	(195)	(115)	(547)
As at 31 December 2008	**4,111**	**1,016**	**9,654**	**1,408**	**16,189**
Accumulated depreciation					
As at 1 January 2008	**489**	**625**	**6,014**	**406**	**7,534**
Charge for the period	80	170	1,123	150	1,523
Disposals	-	(224)	(189)	(93)	(506)
As at 31 December 2008	**569**	**571**	**6,948**	**463**	**8,551**
Net book value					
As at 31 December 2008	**3,542**	**445**	**2,706**	**945**	**7,638**

23 PROPERTY AND EQUIPMENT (continued)

The following table shows changes in property and equipment of the Bank in 2007:

	Land and buildings	Vehicles	Equipment	Leasehold improvements	Total
Cost					
As at 1 January 2007	**4,010**	**1,043**	**7,687**	**1,179**	**13,919**
Additions	82	155	1,315	292	1,844
Disposals	-	(86)	(184)	(12)	(282)
As at 31 December 2007	**4,092**	**1,112**	**8,818**	**1,459**	**15,481**
Accumulated depreciation					
As at 1 January 2007	**413**	**515**	**4,860**	**309**	**6,097**
Charge for the period	76	196	1,331	108	1,711
Disposals	-	(86)	(177)	(11)	(274)
As at 31 December 2007	**489**	**625**	**6,014**	**406**	**7,534**
Net book value					
As at 31 December 2007	**3,603**	**487**	**2,804**	**1,053**	**7,947**

The following table shows changes in property and equipment of the Group in 2008:

	Land and Buildings	Vehicles	Equipment	Leasehold improvements	Total
Cost					
As at 1 January 2008	**4346**	**1,782**	**9,114**	**1,520**	**16,762**
Additions	19	647	1,092	69	1,827

NOTES TO THE FINANCIAL STATEMENTS

Disposals	(139)	(422)	(256)	(115)	(932)
As at 31 December 2008	**4,226**	**2,007**	**9,950**	**1,474**	**17,657**
Accumulated depreciation					
As at 1 January 2008	**531**	**713**	**6,131**	**412**	**7,787**
Charge for the period	88	389	1,193	159	1,829
Disposals	(27)	(310)	(236)	(93)	(666)
As at 31 December 2008	**592**	**792**	**7,088**	**478**	**8,950**
Net book value					
As at 31 December 2008	**3,634**	**1,215**	**2,862**	**996**	**8,707**

The following table shows changes in property and equipment of the Group in 2007:

	Land and Buildings	**Vehicles**	**Equipment**	**Leasehold improvements**	**Total**
Cost					
As at 1 January 2007	**4,217**	**1,104**	**7,864**	**1,180**	**14,365**
Additions	129	843	1,438	352	2,762
Disposals	-	(165)	(188)	(12)	(365)
As at 31 December 2007	**4346**	**1,782**	**9,114**	**1,520**	**16,762**
Accumulated depreciation					
As at 1 January 2007	**445**	**538**	**4,938**	**310**	**6,231**
Charge for the period	86	294	1,373	113	1,866
Disposals	-	(119)	(180)	(11)	(310)
As at 31 December 2007	**531**	**713**	**6,131**	**412**	**7,787**
Net book value					
As at 31 December 2007	**3,815**	**1,069**	**2,983**	**1,108**	**8,975**

24 OTHER ASSETS

	31/12/08		**31/12/07**	
	Group	**Bank**	**Group**	**Bank**
Financial assets	1,782	1,500	1,177	538
Non-financial assets	3,455	62	2,186	286
Total other assets (gross)	**5,237**	**1,562**	**3,363**	**824**
Impairment provision	(237)	(106)	(103)	(103)
Total other assets (net)	**5,000**	**1,456**	**3,260**	**721**

25 DUE TO CREDIT INSTITUTIONS

	31/12/08		**31/12/07**	
	Group	**Bank**	**Group**	**Bank**
Due to credit institutions registered in OECD area	496,249	476,948	491,450	482,886
Due to credit institutions registered in Latvia	18,979	18,979	5,852	5,852
	515,228	**495,927**	**497,302**	**488,738**

	31/12/08		**31/12/07**	
	Group	**Bank**	**Group**	**Bank**
On demand	12,592	12,592	36	36
Term balances	502,636	483,335	497,266	488,702

NOTES TO THE FINANCIAL STATEMENTS

	515,228	**495,927**	**497,302**	**488,738**

The average interest rate for due to credit institutions as at 31 December 2008 was 4.7% (at 31 December 2007: 5.0%).

26 DUE TO CUSTOMERS

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Central government	5,000	5,000	-	-
Local government	5,166	5,166	6,720	6,720
State owned companies	4,499	4,499	5,885	5,885
Financial institutions	32,559	32,639	26,319	26,656
Private companies	43,844	43,875	36,971	37,058
Individuals	202,125	202,125	200,670	200,670
Public and religious organisations	5,196	5,196	2,663	2,663
	298,389	**298,500**	**279,228**	**279,652**
Accrued interest	3,709	3,709	2,896	2,898
Total due to customers	**302,098**	**302,209**	**282,124**	**282,550**

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
On demand	67,880	67,991	79,310	79,413
Term balances	234,218	234,218	202,814	203,137
Total due to customers	**302,098**	**302,209**	**282,124**	**282,550**

26 DUE TO CUSTOMERS (continued)

98.1% of the deposits with the Bank are the Bank's liabilities to residents of Latvia, the remaining 1.9% of the deposits are liabilities to other countries residents.

The average interest rate for demand deposits at 31 December 2008 was 0.4% (0.5% at 31 December 2007), for term deposits – 6.5% (5.8% at 31 December 2007).

27 ISSUED DEBT SECURITIES

	31/12/08	31/12/07
	Bank	**Bank**
Mortgage bonds	40,660	37,317
Other debt securities	-	15,177
Total	**40,660**	**52,494**

The purpose of mortgage bonds issuing was to attract financial resources for refinancing of the long-term mortgage loans. The purpose of debt securities issuing was to attract financial resources for financing general Bank activities.

All mortgage bonds issued by the Bank are assigned A2 rating by Moody's Investors Service. All issued debt securities are quoted on the Official List of the Riga Stock Exchange.

During the 2008, the Bank issued C01CC series mortgage bonds for total amount of EUR 12,739 thousand, but redeemed LVL 4,050 thousand of AI und AJ series mortgage bonds, LVL 10,000 thousand and EUR 9,047 thousand of P01AO and P01CB series debt securities.

NOTES TO THE FINANCIAL STATEMENTS

The average annual interest rate of the issued securities was 5.8% (as at 31 December 2007: 5.9%).

Statement on Mortgage bond coverage as at 31 December 2008

(a) Issued mortgage bonds

ISIN	Security class	Number of mortgage bonds	Face value	Registered volume	Coupon rate, %	Maturity date	Outstanding volume, LVL	Book value LVL
LV0000800183	AK	30,000	100 LVL	3,000,000	6.5%*	15.08.2009.	3,000,000	3,073,667
LV0000800266	AN	30,000	100 LVL	3,000,000	7.625%*	15.08.2010.	3,000,000	3,089,064
LV0000800100	AH	20,000	100 LVL	2,000,000	7.5%	15.08.2011.	1,068,300	1,096,787
LV0000800217	BA	100,000	100 USD	10,000,000	3.875%**	15.08.2011.	2,762,100	2,802,534
LV0000800688	C01CC	250,000	100 EUR	25,000,000	5.70%	15.02.2011.	7,869,296	7,981,949
LV0000800340	CA	200,000	100 EUR	20,000,000	5.4375***	15.02.2012.	14,003,651	14,291,309
LV0000800142	AL	50,000	100 LVL	5,000,000	6.0%	15.08.2012.	4,497,100	4,593,494
LV0000800159	AM	70,000	100 LVL	7,000,000	5.25%	15.08.2013.	3,671,300	3,730,663
						Total	**39,871,747**	**40,659,466**

* floating coupon rate (6 month RIGIBOR plus 0.5%) that is revised twice every year on 15 February and 15 August
** floating coupon rate (6 month LIBOR plus 0.8%) that is revised twice every year on 15 February and 15 August
***floating coupon rate (6 month EURIBOR plus 0.29%) that is revised twice every year on 15 February and 15 August

(b) Structure of Mortgage bond coverage

Mortgage bonds in circulation are secured by assets included in the Mortgage Bond Cover Register which as of 31 December 2008 amounted to LVL 120,219 thousand (as at 31 December 2007: LVL 145,788 thousand). Assets included in the Mortgage Bond Cover Register consisted of mortgage loans (ordinary cover) in the amount of LVL 114,317 thousand (as at 31 December 2007: LVL 142,053 thousand) and substitute cover amounting to LVL 5,902 thousand (as at 31 December 2007: LVL 3,735 thousand).

27 ISSUED DEBT SECURITIES (continued)

As at 31 December 2008, a ratio of substitute cover against amount of mortgage bonds in circulation (maximum statutory allowed – 20%) was 14.0% (as at 31 December 2007: 10.1%), while the amount of assets included in the Mortgage Bond Cover Register exceeds the amount of mortgage bonds in circulation by 68.4% (as at 31 December 2007: 77.1%) of the amount of weighted assets included in the Mortgage Bond Cover Register (minimum statutory requirement: 10%).

(c) Sufficiency Calculation of Cover of Mortgage Bonds in Circulation

M-Bonds Redemption and Coupon Payment Dates	Mortgage Bond Cover Sufficiency on the last Payment Date*	Mortgage Payments receivable		Payments of Mortgage Bonds in Circulation		Substitute Cover	Mortgage Bond Cover Sufficiency
		Principal Payments	Interest Payments	Redemption Payments	Interest Payments		(1+2+3-4-5+6)
A	1	2	3	4	5	6	7
15.02.2009	-	1,431	1,233	-	(1,201)	-	(1,463)
15.08.2009	1,431	7,836	3,971	(3,000)	(1,201)	-	(9,037)
15.02.2010	6,267	6,869	3,626	-	(1,104)	-	(15,658)
15.08.2010	13,136	3,804	3,437	(3,000)	(1,104)	-	(16,273)
15.02.2011	13,940	3,872	3,287	(8,953)	(989)	-	(11,157)
15.08.2011	8,859	5,338	3,119	(4,120)	(734)	-	(12,462)
15.02.2012	10,077	3,303	2,953	(14,056)	(635)	-	(1,642)
15.08.2012	-	3,441	2,827	(5,000)	(251)	-	(1,017)
15.02.2013	-	3,381	2,693	-	(101)	-	(5,973)
15.08.2013	3,381	5,067	2,551	(3,863)	(101)	-	(7,035)
15.02.2014	4,585	3,830	2,396	-	-	-	(10,811)
15.08.2014	8,415	52,464	20,031	-	-	-	(80,910)
15.02.2015	60,879	13,681	5,869	-	-	-	(80,429)

NOTES TO THE FINANCIAL STATEMENTS

Total	**114,317**	**57,993**	**(41,992)**	**(7,421)**	**-**

* mortgage Bond Cover sufficiency on the last Payment Date is calculated: figures shown in Column 7 – (Column 3 – Column 5) on the last Payment Date

(d) Analysis of mortgage loans included in Mortgage bond coverage by type of real estate

	31/12/08 Bank	31/12/07 Bank
Residential mortgage loans	69,851	81,388
Commercial mortgage loans	44,466	60,665
Total	**114,317**	**142,053**

28 OTHER LIABILITIES

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Financial liabilities				
Support programmes financing*	9,249	9,249	7,742	7,742
Other financial liabilities	3,834	3,130	4,221	3,469
	13,083	**12,379**	**11,963**	**11,211**

* Co-financing for realisation of European Social Fund programme "Training, consulting and financial support for commercial activity and self-employment undertakers" and European Regional Development Fund programme "Lending for undertakers of commercial activity

29 DEFERRED TAX LIABILITIES

Movements in the provision for deferred tax liability:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Deferred tax liability at the beginning of the reporting year	**963**	**936**	**899**	**890**
Change in deferred tax liabilities	43	70	64	46
Deferred tax liability at the end of the reporting year	**1,006**	**1,006**	**963**	**936**

Deferred income tax assets and liabilities are attributable to the following items:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Deferred tax liabilities:	**1,175**	**1,075**	**1,169**	**1,123**
Temporary difference of property and equipment depreciation	918	818	859	813
Revaluation of investment property	218	218	262	262
Other temporary differences	39	39	48	48
Deferred tax assets:	**169**	**69**	**206**	**187**
Provision for employee holiday pay	70	63	59	53
Other temporary differences	99	6	147	134
Total provision for deferred taxation	**1,006**	**1,006**	**963**	**936**

NOTES TO THE FINANCIAL STATEMENTS

30 SUBORDINATED LIABILITIES

On 31 March 2008, an agreement was concluded between the Bank and the State Treasury on issuing of a subordinated debt of EUR 30,000 thousand, with a maturity of 30 April 2015 and an interest rate of 5.78 % as at 31 December 2008.

In the reporting period the Bank repaid subordinated debt of LVL 3,300 thousand.

31 SHARE CAPITAL

Share capital as at 31 December 2007 and 31 December 2008 was as follows:

		31/12/08		31/12/07
Fully paid share capital	**Number**	**LVL**	**Number**	**LVL**
Ordinary shares	48,513,143	48,513,143	48,513,143	48,513,143
Total fully paid share capital	**48,513,143**	**48,513,143**	**48,513,143**	**48,513,143**

According to the Articles of Association, the fully paid share capital of the Bank consists of 48,513,143 ordinary shares in the total amount of LVL 48,513,143, owned by the Republic of Latvia. The nominal value of each share is LVL 1.

In 2008, the Bank distributed LVL 1,659 thousand to the Ministry of Finance for the use of the state funds from the profit for 2007. According to the Cabinet of Ministers regulations for the reporting year the Bank has calculated LVL 604 thousand as a payment for the use of the state capital to the Ministry of Finance in respect of 2008 which represents 50% of the Bank's net profit.

Reserve capital of the Bank consists of undistributed profits from 2003 in the amount of LVL 1,249 thousand, which have been transferred to reserve capital. This part of the reserve is distributable based on shareholder decision. The remaining part of the reserve capital is shareholder contribution in kind and reserves of an acquired company. This part of the reserve capital is non-distributable.

31 SHARE CAPITAL (continued)

Reserve capital of the Group consists of Reserve capital of the Bank and undistributed profits from previous years of SIA "Hipotēku bankas nekustamā īpašuma aģentūra" in the amount of LVL 549 thousand and is distibutable based on shareholder decision.

32 CASH AND CASH EQUIVALENTS

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Cash	9,184	9,184	7,374	7,374
Placements with the Bank of Latvia	35,931	35,931	58,891	58,891
Placements with other credit institutions	23,843	23,620	21,552	21,343
Placements with other credit institutions with remaining maturity up to 3 months	10,988	10,958	61,883	61,883
Placements from other credit institutions with remaining maturity up to 3 months	(22,490)	(22,164)	(17,764)	(17,634)
	57,456	**57,529**	**131,936**	**131,857**

33 RELATED PARTY TRANSACTIONS

Related parties are defined as shareholder who has significant influence over the Bank, members of the Council, the Board of Directors and the Bank's higher level management, their close relatives and companies in which they have a controlling interest as well as Bank's subsidiaries and companies, in which the Bank is having a significant influence.

NOTES TO THE FINANCIAL STATEMENTS

The following loans and deposits were held with related parties at 31 December 2008:

	31/12/08 Bank	31/12/07 Bank
Loans:		
- Members of the Council, the Board and high level management	1,867	1,758
- subsidiaries	78,545	86,394
- other related parties	3,800	1,227
Total loans held by related parties	**84,212**	**89,379**
Deposits:		
- Members of the Council and the Board and high level management	463	524
- subsidiaries	88	431
- other related parties	347	246
Total deposits held by related parties	**898**	**1,201**

Bank's income / (expenses) from transactions with related parties:

	2008 Bank	2007 Bank
Interest income from loans to related parties	5,249	3,573
Interest expenses for deposits held from related parties	(35)	(273)
Total income, net	**5,214**	**3,300**

The average interest rate as at 31 December 2008 on loans issued to related parties was 6.4% per annum (5.1% as at 31 December 2007). The average interest rate as at 31 December 2008 on deposits held for related parties was 3.1% per annum (3.9% as at 31 December 2007)

33 RELATED PARTY TRANSACTIONS (continued)

Table below provides assets and liabilities of the Bank related to transactions with the government of the Republic of Latvia, state controlled entities and institutions:

	31/12/08 Bank	31/12/07 Bank
Assets:		
Latvian Treasury bills and government bonds	28,446	13,342
Loans to state controlled entities	2,934	9,381
Total	**31,380**	**22,723**
Liabilities:		
Subordinated liabilities	31,089	13,302
Deposits of central government and state controlled entities	9,499	5,885
Total	**40,588**	**19,187**

Bank's income / (expenses) from transactions with the government of the Republic of Latvia, state controlled entities and institutions:

	2008 Bank	2007 Bank
Interest income	1,182	656
Interest expense	(2,061)	(1,070)
Total expenses, net	**(879)**	**(414)**

34 OFF BALANCE SHEET ITEMS AND CONTINGENT LIABILITIES

NOTES TO THE FINANCIAL STATEMENTS

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Contingent liabilities				
outstanding guarantees	24,007	24,007	11,456	11,456
Financial commitments				
unutilised loan facilities	29,448	39,101	40,781	64,411
other	298	298	1,714	1,714
Total	**53,753**	**63,406**	**53,951**	**77,581**

35 POST BALANCE SHEET EVENTS

Based on Cabinet of Ministers regulation No 275 on 22 May 2008 and in accordance with the agreement between the Bank and the Ministry of Finance of the Republic of Latvia on 28 January 2009 share capital of Mortgage and Land bank of Latvia was increased. In accordance with the agreement, the state took over the liability to repay the loan to Nordic Investment bank in the amount of EUR 42,000,000 and increased the share capital of the Bank by LVL 29,517,768
.
On 7 January 2009 rating agency Moody`s Investors Service decreased the Bank's long term and short term currency rating from A3 to Baa1 and mortgage bonds rating from A1 to A2. Changes in the rating are related to the changes in local and foreign currency ratings of the Republic of Latvia from A3 to Baa1 as well as downturn of the economic environment of the Republic of Latvia.

Based on decision taken by the Cabinet of Ministers of the Republic of Latvia, on 11 January 2009 the Bank signed share purchase agreement with Svenska Handelsbanken AB on purchase of additional 200,000 shares of AS „Parex banka" for EUR 0.01 (one euro cent) thus becoming holder of 85.15% of AS „Parex banka" shares.

On 25 February 2009 in accordance with the agreement between the Bank and V a/s „Privatizācijas aģentūra", 85% of AS „Parex banka" shares were sold to V a/s „Privatizācijas aģentūra". The price of the shares was LVL 2 (two lats) and EUR 0.01 (one euro cent).

36 MAXIMUM EXPOSURE TO CREDIT RISK

The table below shows credit risk exposures relating to on-balance sheet assets and off-balance sheet items before collateral held or other credit enhancements:

	31/12/08		31/12/07	
	Group	**Bank**	**Group**	**Bank**
Credit risk exposures relating to on-balance sheet assets are as follows:				
Trading securities	3,859	3,711	3,269	3,269
Investment securities – held to maturity	64,070	63,969	13,060	13,060
Investment securities – available for sale	26,296	26,296	54,131	54,131
Due from credit institutions	65,587	65,334	104,871	104,662
Derivative financial instruments	1,581	1,581	84	84
Loans to customers	742,386	726,575	667,858	660,350
Other assets	5,000	1,456	3,260	721
	908,779	**888,922**	**846,853**	**836,277**
Credit risk exposures relating to off-balance sheet items are as follows:				
Contingent liabilities	24,007	24,007	11,456	11,456
Financial commitments	29,746	39,399	42,495	66,125
	53,753	**63,406**	**53,951**	**77,581**

37 FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

In respect of financial assets and liabilities held in the balance sheet at carrying values other than fair value, in the opinion of Management the fair value of those financial assets and liabilities differ from their carrying

NOTES TO THE FINANCIAL STATEMENTS

values, as follows:

	31/12/08		31/12/07	
	Book value	**Fair value**	**Book value**	**Fair value**
Assets				
Due from credit institutions	65,587	65,578	104,871	104,853
Loans to customers	742,386	732,785	667,858	665,434
Investment securities held to maturity	64,070	62,792	13,060	12,770
Liabilities				
Due to credit institutions	515,228	515,228	497,302	497,284
Due to customers	302,098	301,197	282,124	281,458
Mortgage bonds	40,660	40,678	52,494	52,908

In assessing the differences of fair value to carrying value, management has performed discounted cash flow analysis where financial assets and liabilities are at fixed rates of interest for fixed period. All items where interest rates are pegged to floating market interest rates have not been recalculated; the carrying value is considered equal to fair value.

38 CONTINGENT LIABILITIES

The tax authorities may at any time inspect the books and records within 3 years subsequent to the reported tax year and may impose additional tax assessments and penalties, if any. The Group's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

39 MOVEMENT IN REVALUTION RESERVE OF INVESTMENT SECURITIES AVAILABLE FOR SALE

	2008		2007	
	Group	**Bank**	**Group**	**Bank**
At 1 January	(1,540)	(1,540)	(615)	(615)
Net losses from changes in fair value	(2,022)	(2,022)	(925)	(925)
At 31 December	**(3,562)**	**(3,562)**	**(1,540)**	**(1,540)**

NOTES TO THE FINANCIAL STATEMENTS

40 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below allocates the Group's assets and liabilities to maturity groupings as at 31 December 2008 based on the time remaining from the balance sheet date to the contractual maturity dates.

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
ASSETS							
Cash and balances with the Central Bank	45,115	-	-	-	-	-	**45,115**
Securities	886	12,659	8,076	7,706	56,865	8,033	**94,225**
Investment properties	-	-	-	-	-	1,826	**1,826**
Due from credit institutions	32,060	2,771	4,046	24,889	1,821	-	**65,587**
Loans to customers	28,623	29,526	45,878	75,422	228,272	334,665	**742,386**
Derivative financial instruments	273	779	529	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	-	-	-	-	-	296	**296**
Intangible assets	-	-	-	-	-	2,434	**2,434**
Property and equipment	-	-	-	-	-	8,707	**8,707**
Other assets	-	-	-	-	-	6,147	**6,147**
Deferred expenses and accrued income	-	-	-	-	-	718	**718**
Total assets	**106,957**	**45,735**	**58,529**	**108,017**	**286,958**	**362,826**	**969,022**
LIABILITIES AND SHAREHOLDERS EQUITY							
Due to credit institutions	15,607	6,883	18,807	138,467	290,051	45,413	**515,228**
Due to customers	125,336	44,156	62,942	58,831	10,293	540	**302,098**
Derivative financial instruments	-	24	75	447	-	-	**546**
Transit funds	-	-	177	157	1,369	573	**2,276**

NOTES TO THE FINANCIAL STATEMENTS

Mortgage bonds	-	908	-	3,000	36,752	-	**40,660**
Other liabilities	-	-	-	-	-	13,083	**13,083**
Deferred income and accrued expenses	-	-	-	-	-	2,610	**2,610**
Deferred tax liabilities	-	-	-	-	-	1,006	**1,006**
Subordinated debt	-	-	5		10,000	21,084	**31,089**
Shareholder's equity	-	-	-	-	-	60,426	**60,426**
Total liabilities and shareholder's equity	**140,943**	**51,971**	**82,006**	**200,902**	**348,465**	**144,735**	**969,022**
Net liquidity	**(33,986)**	**(6,236)**	**(23,477)**	**(92,885)**	**(61,507)**	**218,091**	**-**
As at 31 December 2007							
Total assets	**165,713**	**43,396**	**65,659**	**78,407**	**306,051**	**268,364**	**927,590**
Total liabilities and shareholder's equity	**129,538**	**68,094**	**59,852**	**105,682**	**440,108**	**124,316**	**927,590**
Net liquidity	**36,175**	**(24,698)**	**5,807**	**(27,275)**	**(134,057)**	**144,048**	-

40 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

The table below allocates the Bank's assets and liabilities to maturity groupings as at 31 December 2008 based on the time remaining from the balance sheet date to the contractual maturity dates.

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
ASSETS							
Cash and balances with the Central Bank	45,115	-	-	-	-	-	**45,115**
Securities	738	12,659	8,021	7,660	56,865	8,033	**93,976**
Investment properties	-	-	-	-	-	1,826	**1,826**
Due from credit institutions	31,807	2,771	4,046	24,889	1,821	-	**65,334**
Loans to customers	26,139	25,713	42,477	64,164	236,229	331,853	**726,575**
Derivative financial instruments	273	779	529	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	-	-	-	-	-	898	**898**
Intangible assets	-		-	-	-	1,942	**1,942**
Property and equipment	-	-	-	-	-	7,638	**7,638**
Other assets	-	-	-	-	-	2,460	**2,460**
Deferred expenses and accrued income	-	-	-	-	-	564	**564**
Total assets	**104,072**	**41,922**	**55,073**	**96,713**	**294,915**	**355,214**	**947,909**
LIABILITIES AND SHAREHOLDERS EQUITY							
Due to credit institutions	15,607	6,557	18,807	119,492	290,051	45,413	**495,927**
Due to customers	125,447	44,156	62,942	58,831	10,293	540	**302,209**
Derivative financial instruments	-	24	75	447	-	-	**546**
Transit funds	-	-	177	157	1,369	573	**2,276**

NOTES TO THE FINANCIAL STATEMENTS

Mortgage bonds	-	908	-	3,000	36,752	-	**40,660**
Other liabilities	-	-	-	-	-	12,379	**12,379**
Deferred income and accrued expenses	-	-	-	-	-	1,882	**1,882**
Deferred tax liabilities	-	-	-	-	-	1,006	**1,006**
Subordinated debt	-	-	5	-	10,000	21,084	**31,089**
Shareholder's equity	-	-	-	-	-	59,935	**59,935**
Total liabilities and shareholder's equity	**141,054**	**51,645**	**82,006**	**181,927**	**348,465**	**142,812**	**947,909**
Net liquidity	**(36,982)**	**(9,723)**	**(26,933)**	**(85,214)**	**(53,550)**	**21,2402**	**-**
As at 31 December 2007							
Total assets	**162,965**	**36,688**	**59,526**	**67,076**	**244,731**	**345,441**	**916,427**
Total liabilities and shareholder's equity	**129,964**	**67,964**	**59,852**	**97,248**	**440,108**	**121,291**	**916,427**
Net liquidity	**33,001**	**(31,276)**	**(326)**	**(30,172)**	**(195,377)**	**224,150**	-

40 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

The table below allocates the Group's financial liabilities undiscounted cash flows as at 31 December 2008:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Due to credit institutions	15,786	9,064	24,592	149,250	321,943	48,000	**568,635**
Due to customers	125,633	45,290	64,762	61,143	11,131	541	**308,500**
Transit funds	-	-	227	226	1,724	609	**2,786**
Mortgage bonds	-	1,201	-	4,201	44,011	-	**49,413**
Other liabilities	-	-	-	-	-	13,083	**13,083**
Subordinated debt	-	-	895	948	16,710	22,624	**41,177**
	141,419	**55,555**	**90,476**	**215,768**	**395,519**	**84,857**	**983,594**

The table below allocates the Bank's financial liabilities undiscounted cash flows as at 31 December 2008:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Due to credit institutions	15,786	8,510	24,592	129,720	321,943	48,000	**548,551**
Due to customers	125,744	45,290	64,762	61,143	11,131	541	**308,611**
Transit funds	-	-	227	226	1,724	609	**2,786**
Mortgage bonds	-	1,201	-	4,201	44,011	-	**49,413**
Other liabilities	-	-	-	-	-	12,379	**12,379**
Subordinated debt	-	-	895	948	16,710	22,624	**41,177**
	141,530	**55,001**	**90,476**	**196,238**	**395,519**	**84,153**	**962,917**

NOTES TO THE FINANCIAL STATEMENTS

The table below allocates the Group's financial liabilities undiscounted cash flows as at 31 December 2007:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Due to credit institutions	1,156	20,610	15,286	59,208	435,336	33,466	**565,062**
Due to customers	128,593	51,527	36,427	52,812	17,648	405	**287,412**
Transit funds	-	-	225	223	1,722	1,020	**3,190**
Mortgage bonds		1,051	15,613	5,086	34,426	3,940	**60,116**
Other liabilities	-	-	-	-	-	11,963	**11,963**
Subordinated debt	-	-	391	3,623	2,272	10,059	**16,345**
	129,749	**73,188**	**67,942**	**120,952**	**491,404**	**60,853**	**944,088**

The table below allocates the Bank's financial liabilities undiscounted cash flows as at 31 December 2007:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Due to credit institutions	1,156	20,400	15,286	50,564	435,336	33,466	**556,208**
Due to customers	129,019	51,527	36,427	52,812	17,648	405	**287,838**
Transit funds	-	-	225	223	1,722	1,020	**3,190**
Mortgage bonds	-	1,051	15,613	5,086	34,426	3,940	**60,116**
Other liabilities	-	-	-	-	-	11,211	**11,211**
Subordinated debt	-	-	391	3,623	2,272	10,059	**16,345**
	130,175	**72,978**	**67,942**	**112,308**	**491,404**	**60,101**	**934,908**

40 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

The table below allocates the Group's derivative cash flows as at 31 December 2008:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Derivatives settled on a gross basis							
Foreign exchange derivatives							
outflow	22,644	17,453	63,927	9,779	-	-	**113,803**
inflow	22,961	18,418	64,905	10,000	-	-	**116,284**

The table below allocates the Bank's derivative cash flows as at 31 December 2008:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Derivatives settled on a gross basis							
Foreign exchange derivatives							
outflow	22,644	17,453	63,927	9,779	-	-	**113,803**
inflow	22,961	18,418	64,905	10,000	-	-	**116,284**

The table below allocates the Group's derivative cash flows as at 31 December 2007:

NOTES TO THE FINANCIAL STATEMENTS

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Derivatives settled on a gross basis							
Foreign exchange derivatives							
outflow	7,622	3,076	4,376	-	-	-	**15,074**
inflow	7,535	3,060	4,435	-	-	-	**15,030**

The table below allocates the Bank's derivative cash flows as at 31 December 2007:

	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	1 to 5 years	Over 5 years and undated	**Total**
Derivatives settled on a gross basis							
Foreign exchange derivatives							
outflow	7,622	3,076	4,376	-	-	-	**15,074**
inflow	7,535	3,060	4,435	-	-	-	**15,030**

41 RE-PRICING MATURITY ANALYSIS

The table below allocates the Group's assets and liabilities to maturity groupings as at 31 December 2008 based on the time remaining from the balance sheet date to the earlier of maturity and contractual re-pricing dates.

	Up to 1 month	1 to 3 month	3 to 6 month	6 to 12 month	1 to 5 years	Over 5 years	Non-interest bearing	**Total**
ASSETS								
Cash and balances with the Central Bank	45,115	-	-	-	-	-	-	**45,115**
Securities	11,743	19,763	15,601	5,111	34,101	7,847	59	**94,225**
Investment properties	-	-	-	-	-	-	1,826	**1,826**
Due from credit institutions	43,963	6,750	4,601	10,273	-	-	-	**65,587**
Loans to customers	197,047	164,729	212,683	39,217	113,172	15,538	-	**742,386**
Derivative financial instruments	273	779	529	-	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	-	-	-	-	-	-	296	**296**
Intangible assets	-	-	-	-	-	-	2,434	**2,434**
Property and equipment	-	-	-	-	-	-	8,707	**8,707**
Other assets	-	-	-	-	-	-	6,147	**6,147**
Deferred expenses and accrued income	-	-	-	-	-	-	718	**718**
Total assets	**298,141**	**192,021**	**233,414**	**54,601**	**147,273**	**23,385**	**20,187**	**969,022**

LIABILITIES AND

NOTES TO THE FINANCIAL STATEMENTS

SHAREHOLDERS EQUITY								
Due to credit institutions	148,459	275,332	91,437	-	-	-	-	**515,228**
Due to customers	125,336	44,156	62,942	58,831	10,293	540	-	**302,098**
Derivative financial instruments	-	24	75	447	-	-	-	**546**
Transit funds	-	2,276	-	-	-	-	-	**2,276**
Mortgage bonds	-	22,573	-	-	18,087	-	-	**40,660**
Other liabilities	-	-	-	-	-	-	13,083	**13,083**
Deferred income and accrued expenses	-	-	-	-	-	-	2,610	**2,610**
Deferred tax liability	-	-	-	-	-	-	1,006	**1,006**
Subordinated debt	-	-	5	-	10,000	21,084	-	**31,089**
Shareholder's equity	-	-	-	-	-	-	60,426	**60,426**
Total liabilities and shareholder's equity	**273,795**	**344,361**	**154,459**	**59,278**	**38,380**	**21,624**	**77,125**	**969,022**
On balance sheet interest sensitivity analysis	**24,346**	**(152,340)**	**78,955**	**(4,677)**	**108,893**	**1,761**	**(56,938)**	**-**
<u>As at 31 December 2007</u>								
Total assets	**334,037**	**180,307**	**246,780**	**17,300**	**107,868**	**23,036**	**18,262**	**927,590**
Total liabilities and shareholder's equity	**145,488**	**498,521**	**111,104**	**56,499**	**22,184**	**14,131**	**79,663**	**927,590**
On balance sheet interest sensitivity analysis	**188,549**	**(318,214)**	**135,676**	**(39,199)**	**85,684**	**8,905**	**(61,401)**	**-**

41 RE-PRICING MATURITY ANALYSIS (continued)

The table below allocates the Bank's assets and liabilities to maturity groupings as at 31 December 2008 based on the time remaining from the balance sheet date to the earlier of maturity and contractual re-pricing dates.

	Up to 1 month	1 to 3 month	3 to 6 month	6 to 12 month	1 to 5 years	Over 5 years	Non-interest bearing	**Total**
ASSETS								
Cash and balances with the Central Bank	45,115	-	-	-	-	-	-	**45,115**
Securities	11,595	19,763	15,546	5,065	34,101	7,847	59	**93,976**
Investment properties	-	-	-	-	-	-	1,826	**1,826**
Due from credit institutions	43,710	6,750	4,601	10,273	-	-	-	**65,334**
Loans to customers	181,914	165,090	212,551	39,041	112,444	15,535	-	**726,575**
Derivative financial instruments	273	779	529	-	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	-	-	-	-	-	-	898	**898**
Intangible assets	-	-	-	-	-	-	1,942	**1,942**
Property and equipment	-	-	-	-	-	-	7,638	**7,638**
Other assets	-	-	--	-	-	-	2,460	**2,460**
Deferred expenses and accrued income	-	-	-	-	-	-	564	**564**
Total assets	**282,607**	**192,382**	**233,227**	**54,379**	**146,545**	**23,382**	**15,387**	**947,909**

LIABILITIES AND

NOTES TO THE FINANCIAL STATEMENTS

SHAREHOLDERS EQUITY								
Due to credit institutions	148,459	256,031	91,437	-	-	-	-	**495,927**
Due to customers	125,447	44,156	62,942	58,831	10,293	540	-	**302,209**
Derivative financial instruments	-	24	75	447	-	-	-	**546**
Transit funds	-	2,276	-	-	-	-	-	**2,276**
Mortgage bonds	-	22,573	-	-	18,087	-	-	**40,660**
Other liabilities	-	-	-	-	-	-	12,379	**12,379**
Deferred income and accrued expenses	-	-	-	-	-	-	1,882	**1,882**
Deferred tax liability	-	-	-	-	-	-	1,006	**1,006**
Subordinated debt	-	-	5	-	10,000	21,084	-	**31,089**
Shareholder's equity	-	-	-	-	-	-	59,935	**59,935**
Total liabilities and shareholder's equity	**273,906**	**325,060**	**154,459**	**59,278**	**38,380**	**21,624**	**75,202**	**947,909**
On balance sheet interest sensitivity analysis	**8,701**	**(132,678)**	**78,768**	**(4,899)**	**108,165**	**1,758**	**(59,815)**	**-**
As at 31 December 2007								
Total assets	**326,005**	**181,049**	**246,701**	**17,131**	**107,438**	**23,287**	**14,816**	**916,427**
Total liabilities and shareholder's equity	**145,914**	**489,957**	**111,104**	**56,499**	**22,184**	**14,131**	**76,638**	**916,427**
On balance sheet interest sensitivity analysis	**180,091**	**(308,908)**	**135,597**	**(39,368)**	**85,254**	**9,156**	**(61,822)**	**-**

42 CURRENCY ANALYSIS OF ASSETS AND LIABILITIES

The following table provides the analysis of the Group's assets, liabilities and shareholders' equity as well as memorandum items outstanding as at 31 December 2008 by currency profile:

	LVL	USD	EUR	Other	**Total**
ASSETS					
Cash and balances with the Central Bank	42,300	555	1,807	453	**45,115**
Securities	28,562	18,804	46,859	-	**94,225**
Investment properties	1,826	-	-	-	**1,826**
Due from credit institutions	13,797	13,555	37,899	336	**65,587**
Loans to customers	116,042	8,215	617,410	719	**742,386**
Derivative financial instruments	1,581	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	296	-	-	-	**296**
Intangible assets	2,434	-	-	-	**2,434**
Property and equipment	8,707	-	-	-	**8,707**
Other assets	5,223	14	157	753	**6,147**
Deferred expenses and accrued income	508	2	208	-	**718**
Total assets	**221,276**	**41,145**	**704,340**	**2,261**	**969,022**
LIABILITIES AND SHAREHOLDERS EQUITY					
Due to credit institutions	18,628	-	496,600	-	**515,228**
Due to customers	161,823	23,284	116,645	346	**302,098**
Derivative financial instruments	546	-	-	-	**546**
Transit funds	413	-	1,863	-	**2,276**

NOTES TO THE FINANCIAL STATEMENTS

Mortgage bonds	15,583	2,802	22,275	-	**40,660**
Other liabilities	10,229	92	2,762	-	**13,083**
Deferred income and accrued expenses	2,599	1	10	-	**2,610**
Deferred tax liabilities	1,006	-	-	-	**1,006**
Subordinated debt	10,002	-	21,087	-	**31,089**
Shareholders equity	60,426	-	-	-	**60,426**
Total liabilities and shareholder's equity	**281,255**	**26,179**	**661,242**	**346**	**969,022**
Spot foreign exchange receivables / (payables)	(562)	-	563	-	1
Forward foreign exchange receivables / (payables)	69,939	(15,347)	(50,613)	(1,498)	2,481
Currency position	**9,398**	**(381)**	**(6,952)**	**417**	**2,482**
As at 31 December 2007					
Total assets	**274,836**	**42,204**	**609,944**	**606**	**927,590**
Total liabilities and shareholder's equity	**285,734**	**30,252**	**611,160**	**444**	**927,590**
Spot foreign exchange receivables / (payables)	696	142	(893)	49	(6)
Forward foreign exchange receivables / (payables)	11,925	(12,462)	492	-	(45)
Currency position	**1,723**	**(368)**	**(1,617)**	**211**	**(51)**

42 CURRENCY ANALYSIS OF ASSETS AND LIABILITIES (continued)

The following table provides the analysis of the Bank's assets, liabilities and shareholders' equity as well as memorandum items outstanding as at 31 December 2008 by currency profile:

	LVL	USD	EUR	Other	**Total**
ASSETS					
Cash and balances with the Central Bank	42,300	555	1,807	453	**45,115**
Securities	28,444	18,804	46,728	-	**93,976**
Investment properties	1,826	-	-	-	**1,826**
Due from credit institutions	13,729	13,555	37,714	336	**65,334**
Loans to customers	116,451	8,164	601,241	719	**726,575**
Derivative financial instruments	1,581	-	-	-	**1,581**
Investment in subsidiaries and associated undertakings	898	-	-	-	**898**
Intangible assets	1,942	-	-	-	**1,942**
Property and equipment	7,638	-	-	-	**7,638**
Other assets	1,555	14	138	753	**2,460**
Deferred expenses and accrued income	354	2	208	-	**564**
Total assets	**216,718**	**41094**	**687,836**	**2,261**	**947,909**
LIABILITIES AND SHAREHOLDERS EQUITY					
Due to credit institutions	18,628		477,299		**495,927**
Due to customers	161,902	23,284	116,677	346	**302,209**
Derivative financial instruments	546	-	-	-	**546**
Transit funds	413	-	1,863	-	**2,276**
Mortgage bonds	15,583	2,802	22,275	-	**40,660**

NOTES TO THE FINANCIAL STATEMENTS

Other liabilities	9,873	92	2,414	-	**12,379**
Deferred income and accrued expenses	1,871	1	10	-	**1,882**
Deferred tax liabilities	1,006	-	-	-	**1,006**
Subordinated debt	10,002	-	21,087	-	**31,089**
Shareholders equity	59,935	-	-	-	**59,935**
Total liabilities and shareholder's equity	**279,759**	**26,179**	**641,625**	**346**	**947,909**
Spot foreign exchange receivables/ (payables)	(562)	-	563	-	1
Forward foreign exchange receivables / (payables)	69,939	(15,347)	(50,613)	(1,498)	2,481
Currency position	**6,336**	**(432)**	**(3,839)**	**417**	**2,482**
As at 31 December 2007					
Total assets	**271,218**	**42,191**	**602,412**	**606**	**916,427**
Total liabilities and shareholder's equity	**283,575**	**30,256**	**602,152**	**444**	**916,427**
Spot foreign exchange receivables / (payables)	696	142	(893)	49	(6)
Forward foreign exchange receivables / (payables)	11,925	(12,462)	492	-	(45)
Currency position	**264**	**(385)**	**(141)**	**211**	**(51)**

43 CAPITAL ADEQUACY CALCULATION

Based on the requirements set by the Financial and Capital Market Commission (FCMC), the Group's and the Bank's equity to be utilised in the capital adequacy ratio as at 31 December 2008 has been calculated as follows:

	31/12/2008	
	Group	**Bank**
Tier 1		
- paid-in share capital	48,513	48,513
- legal and other reserves	2,551	2,063
- audited retained earnings	11,296	10,267
- profit for the period	181	1,207
- negative revaluation reserve on investment securities available-for-sale	(3,562)	(3,562)
- intangible assets	(2,434)	(1,942)
Total Tier 1	**56,545**	**56,546**
Tier 2		
- subordinated capital (restricted to 50% of Tier 1)	29,084	29,084
- decrease of subordinated capital	(811)	(811)
Total Tier 2	**28,273**	**28,273**
Capital base	**84,818**	**84,819**

The total of Tier 2 may not exceed the total of Tier 1.

NOTES TO THE FINANCIAL STATEMENTS

43 CAPITAL ADEQUACY CALCULATION (continued)

The following table shows the Group's asset weightings used in calculation of capital adequacy ratio according to the FCMC requirements and calculation of the Group's capital adequacy ratio according to the FCMC requirements:

	Credit equivalent	Balance	Risk weighted assets
Assets and off-balance sheet items			
Claims or contingent claims on central governments or central banks		74,971	2,616
Claims or contingent claims on regional governments or local authorities		1,594	1,061
Claims or contingent claims on institutions		102,763	64,393
Claims in the form of covered bonds		13,496	6,748
Claims or contingent claims on corporates		659,441	632,526
Retail claims or contingent retail claims		107,350	79,381
Past due items		37,181	47,223
Other claims		21,964	13,721
Derivative financial instruments	2,265	1,581	1,218
Deductions from capital:			
Intangible assets		2,434	-
Total assets and off-balance sheet items		**1,022,775**	**848,887**
Calculation of capital requirements			
Capital requirement for the Group's portfolio credit risk	8%		67,911
Operational risk capital requirement			4,598
Capital requirements for market risk			-

NOTES TO THE FINANCIAL STATEMENTS

Capital requirement for the Group's portfolio credit risk and market risk	**72,509**
Capital base	**84,818**
Capital adequacy ratio (Capital base / Capital requirement x 8%)	**9.4%**

43 CAPITAL ADEQUACY CALCULATION (continued)

The following table shows the Bank's asset weightings used in calculation of capital adequacy ratio according to the FCMC requirements and calculation of the Bank's capital adequacy ratio according to the FCMC requirements:

	Credit equivalent	Balance	Risk weighted assets
Assets and off-balance sheet items			
Claims or contingent claims on central governments or central banks		74,971	2,616
Claims or contingent claims on regional governments or local authorities		1,228	695
Claims or contingent claims on institutions		102,261	64,002
Claims in the form of covered bonds		13,496	6,748
Claims or contingent claims on corporates		654,417	627,502
Retail claims or contingent retail claims		107,350	79,381
Past due items		36,412	46,070
Other claims		17,657	9,414
Derivative financial instruments	2,265	1,581	1,218
Deductions from capital:			
Intangible assets		1,942	-
Total assets and off-balance sheet items		**1,011,315**	**837,646**
Calculation of capital requirements			
Capital requirement for the Group's portfolio credit risk	8%		67,012
Operational risk capital requirement			3,539

NOTES TO THE FINANCIAL STATEMENTS

Capital requirements for market risk	-
Capital requirement for the Group's portfolio credit risk and market risk	**70,551**
Capital base	**84,819**
Capital adequacy ratio (Capital base / Capital requirement x 8%)	**9.6%**

44 FUTURE MINIMUM LEASE PAYMENTS FOR OPERATIONAL LEASES

The following table discloses future minimum lease payments for premises operational leases (other lease payments also exist while those are comparatively small):

	Group	Bank
Year 2009	1,166	1,084
Year 2010	1,159	1,077
Year 2011	850	768
Year 2012	562	480
Year 2013 and later	4,702	4,702
Total	**8,439**	**8,111**

45 ANALYSIS OF FINANCIAL ASSETS AND LIABILITIES BY MEASUREMENT

The assets and liabilities of the Group as at 31 December 2008 by measurement are as follows:

	Held to trading	Available for sale	Amortised cost	Total book value
ASSETS				
Cash and balances with the Central Bank	-	-	45,115	**45,115**
Securities	3,859	26,296	64,070	**94,225**
Investment properties	1,826	-	-	**1,826**
Due from credit institutions	-	-	65,587	**65,587**
Loans to customers	-	-	742,386	**742,386**
Derivative financial instruments	1,581	-	-	**1,581**
Other financial assets	-	-	1,545	**1,545**
Total financial assets	**7,266**	**26,296**	**918,703**	**952,265**
Non-financial assets	-	-	-	**16,757**
Total assets	**7,266**	**26,296**	**918,703**	**969,022**
				0
				0
LIABILITIES				**0**
Due to credit institutions	-	-	515,228	**515,228**
Due to customers	-	-	302,098	**302,098**
Derivative financial instruments	546	-	-	**546**
Transit funds	-	-	2,276	**2,276**
Mortgage bonds	-	-	40,660	**40,660**
Subordinated liabilities	-	-	31,089	**31,089**
Other financial liabilities	-	-	13,083	**13,083**

NOTES TO THE FINANCIAL STATEMENTS

Total financial liabilities	**546**	**-**	**904,434**	**904,980**
Non-financial liabilities	-	-	-	**64,042**
Total liabilities	**546**	**-**	**904,434**	**969,022**

45 ANALYSIS OF FINANCIAL ASSETS AND LIABILITIES BY MEASUREMENT (continued)

The assets and liabilities of the Bank as at 31 December 2008 by measurement are as follows:

	Held to trading	Available for sale	Amortised cost	Total book value
ASSETS				
Cash and balances with the Central Bank	-	-	45,115	**45,115**
Securities	3,711	26,296	63,969	**93,976**
Investment properties	1,826	-	-	**1,826**
Due from credit institutions	-	-	65,334	**65,334**
Loans to customers	-	-	726,575	**726,575**
Derivative financial instruments	1,581	-	-	**1,581**
Other financial assets	-	-	1,394	**1,394**
Total financial assets	**7,118**	**26,296**	**902,387**	**935,801**
Non-financial assets	**-**	**-**	**-**	**12,108**
Total assets	**7,118**	**26,296**	**902,387**	**947,909**
LIABILITIES				
Due to credit institutions	-	-	495,927	**495,927**
Due to customers	-	-	302,209	**302,209**
Derivative financial instruments	546	-	-	**546**
Transit funds	-	-	2,276	**2,276**
Mortgage bonds	-	-	40,660	**40,660**
Subordinated liabilities	-	-	31,089	**31,089**
Other financial liabilities	-	-	12,379	**12,379**

NOTES TO THE FINANCIAL STATEMENTS

Total financial liabilities	**546**	**-**	**884,540**	**885,086**
Non-financial liabilities	**-**	**-**	**-**	**62,823**
Total liabilities	**546**	**-**	**884,540**	**947,909**